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No.

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This Court has held that antitrust "*per se* rules are appropriate only for conduct that . . . would always or almost always tend to restrict competition." Modern economic analysis establishes that vertical minimum resale price maintenance does not meet this condition because the practice often has substantial competition-enhancing effects. The question presented is whether vertical minimum resale price maintenance agreements should be deemed *per se* illegal under Section 1 of the Sherman Act, or whether they should instead be evaluated under the rule of reason.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

In addition to the parties named in the caption, Toni Cochran L.L.C., doing business as Toni's, was a plaintiff below.

Pursuant to this Court's Rule 29.6, undersigned counsel state that Leegin Creative Leather Products, Inc. is a wholly owned division of Brighton Collectibles, Inc. No publicly held company owns 10% or more of its stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Leegin Creative Leather Products, Inc. ("Leegin") respectfully submits this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The court of appeals' opinion is unpublished but electronically reported at 2006 WL 690946. App., *infra*, at 1a. The order denying Leegin's petitions for rehearing and for rehearing en banc is unreported. *Id.* at 16a. The opinion of the United States District Court for the Eastern District of Texas is unreported. *Id.* at 12a.

JURISDICTION

The district court had jurisdiction over respondent's claims pursuant to 28 U.S.C. § 1331. The court of appeals had jurisdiction to review the district court's final judgment pursuant to 28 U.S.C. § 1291. The court of appeals filed its opinion on March 20, 2006. It denied Leegin's timely petitions for rehearing and for rehearing en banc on July 19, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 1 of the Sherman Act (15 U.S.C. § 1) provides, in pertinent part:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is hereby declared to be illegal.

STATEMENT

This case is an ideal vehicle for this Court to revisit its decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which relied upon the antiquated common-law rule against "restraints on alienation" to hold that a vertical agreement between a manufacturer and its retailers establishing minimum resale prices for the manufacturer's goods is a *per se* violation of the Sherman Act. *Id.* at 404. This *per se* rule—on which the Fifth Circuit relied in affirming the district court's judgment—squarely conflicts with accumulated economic knowledge, which recognizes that vertical minimum resale price maintenance can have significant *procompetitive* effects, and with this Court's modern antitrust jurisprudence, including decisions revisiting and rejecting analogous *per se* rules prohibiting other vertical agreements. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). As in *Khan* and *Sylvania*, the *per se* rule at issue here has been subject to overwhelming criticism and lacks support under the economic approach that this Court's recent antitrust jurisprudence has applied.

1. Leegin has built a successful family business in the crowded and intensely competitive marketplace for women's fashion accessories. In 1990, Leegin introduced the "Brighton" brand with a line of women's belts, and it later added other types of accessories to the Brighton line. Leegin has differentiated its products from the myriad other brands of leather goods and accessories available in department stores and mass merchandisers by focusing on boutique stores offering a level of service and personal attention that consumers often cannot find elsewhere. 6.R.5-11.[1]

Leegin's strategy has succeeded. Brighton has become a brand equated with quality, value, and customer service.

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[1] "R" refers to the record on appeal. Citations to the record are to the volume of the record, followed by the page number in that volume.

Brighton products did not even exist until 1990, yet ten years later, despite competition from hundreds of other brands of women's accessories, Brighton products were sold in more than 5,000 specialty stores nationwide. 5.R.125-26; 6.R.17-20; 7.R.15. While Leegin has achieved impressive success from its humble beginnings, it is still a small company when compared to the much larger manufacturers and department stores with which it and its retailers compete. 3.R.813-20.

2. In 1997, Leegin instituted the "Brighton Retail Pricing and Promotion Policy," pursuant to which Leegin announced that it would do business exclusively with retailers who follow its suggested retail prices for Brighton products. 6.R.10.[2] There were two principal reasons for Leegin's adoption of the pricing policy. First, it was Leegin's view that the typical retail strategy of putting products on and off "sale" degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment. 5.R.106-24. Leegin's policy instead furthered an "everyday fair price" approach. *Id.* Second, the pricing policy was designed to develop the Brighton brand by giving retailers incentives to provide special attention and service to Brighton customers. 5.R.115-27. In small specialty stores, attractive presentation and customer service are central to the shopping experience, but providing those services is not costless to retailers. *Id.* Through its pricing policy, Leegin ensured a sufficient margin to retailers to give them the incentive to focus on Brighton products and to provide high-quality service. *Id.*

Leegin's pricing policy was successful, and sales of Brighton products grew considerably after its inception. For example, sales of Brighton handbags increased from 125,609 units in 1996, to 375,480 units in 2003. *See* Expert Report of Kenneth G. Elzinga ("Elzinga Report") at 20 n.26 (App., *infra*, at 37a).

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[2] Leegin's pricing policy permitted retailers to discount products that they did not wish to re-order from Leegin.

3. Plaintiff PSKS, which operated a retail store known as "Kay's Kloset" in Lewisville, Texas, was one of the stores to which Leegin sold Brighton products. In December 2002, Leegin learned that PSKS was selling all Brighton products below the suggested prices, in violation of Leegin's pricing policy. 6.R.112-13. In response, Leegin suspended all shipments of Brighton products to PSKS. 6.R.118-19; 7.R.102-09. PSKS then filed this suit, alleging that Leegin's pricing policy constituted an unlawful agreement in restraint of trade.

The district court refused to allow Leegin to introduce evidence that its pricing policy promoted interbrand competition, and excluded the testimony of Leegin's economic expert, Professor Kenneth G. Elzinga. 1.R.325-33. Professor Elzinga would have testified, *inter alia*, that Leegin lacks market power and that its pricing practices are procompetitive because they foster interbrand competition. Elzinga Report at 5-20 (App., *infra*, at 22a-37a). The district court also denied Leegin's request for an instruction that would have allowed the jury to apply the rule of reason (1.R.190-92), which requires an antitrust plaintiff to demonstrate that the defendant's conduct unreasonably restrains competition in a relevant market before it will be found unlawful (*see Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006)), and instead instructed the jury that the alleged resale price maintenance agreement is *per se* unlawful (11.R.42).

The jury found that Leegin's policy constituted a resale price maintenance agreement, and based on the verdict, the court awarded PSKS $3.6 million in damages and $375,000 in attorneys' fees. App., *infra*, at 3a. Leegin renewed its motion for judgment as a matter of law and moved in the alternative for a new trial. The court denied Leegin's motions, stating that "[w]hether the per se classification of such agreements is wise is not for this court to decide." *Id.* at 12a.

The Fifth Circuit affirmed the district court's decision, rejecting Leegin's request for rule-of-reason treatment because lower courts "remain bound by [the Supreme Court's]

holding in *Dr. Miles*." App., *infra*, at 4a. The Fifth Circuit called for a response to Leegin's petitions for rehearing and for rehearing en banc, but eventually denied the petitions.

After the Fifth Circuit refused to stay its mandate, Leegin applied to Justice Scalia for a stay pending the filing and disposition of a petition for a writ of certiorari. No. 06A179. Justice Scalia granted a temporary stay pending a response from PSKS. After a response was received, Justice Scalia referred the application to the Court, which granted the stay pending the filing and disposition of this petition.

REASONS FOR GRANTING THE PETITION

The *per se* rule against resale price maintenance squarely conflicts with this Court's modern antitrust jurisprudence, which has rejected *per se* treatment of analogous vertical agreements because such treatment lacked an economic justification. *See Sylvania*, 433 U.S. at 47-48 (rejecting the *per se* rule against vertical nonprice restraints, and explaining that the "great weight of scholarly opinion ha[d] been critical of the" rule); *Khan*, 522 U.S. at 18 (unanimously overturning the *per se* rule against vertical maximum price-fixing because there was "insufficient economic justification" for the rule); *see also Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 126 S. Ct. 1281, 1290-91 (2006) (unanimously overturning the presumption of *per se* illegality of a tying arrangement involving a patented product because it was inconsistent with economic analysis). Like the *per se* rules rejected in *Sylvania*, *Khan*, and *Independent Ink*, the rule of *Dr. Miles* has no foundation in economic theory because it is well-established that vertical minimum resale price maintenance agreements often have substantial procompetitive effects. The validity of such agreements is therefore more appropriately determined under the rule of reason, rather than through application of a rigid *per se* rule.

This Court "presumptively applies rule of reason analysis" to antitrust claims. *Dagher*, 126 S. Ct. at 1279. The Court has emphasized that a "departure from the rule-of-reason standard must be based upon demonstrable economic

effect." *Sylvania*, 433 U.S. at 58-59. The *per se* prohibition on resale price maintenance, however, rests upon outdated common-law notions that are inconsistent with economic theory and that were expressly rejected by this Court in *Sylvania* and *Khan*. Not surprisingly, legal and economic commentators have leveled sharp criticism at this *per se* rule, pointing out that it lacks any economic justification. For example, Judge Posner has described the *per se* rule against resale price maintenance as "a sad mistake," explaining that "[t]here is neither theoretical basis, nor empirical support, for thinking the practice generally anticompetitive." Richard A. Posner, *Antitrust Law* 189 (2d ed. 2001) [hereinafter Posner, *Antitrust Law*]. Numerous other commentators are in accord. *See, e.g.*, Thomas R. Overstreet, Jr., Bureau of Econ., Fed. Trade Comm'n, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 164 (1983) ("the economic theories and the available empirical evidence rather clearly suggest that the rigid application of a strict standard of *per se* illegality for RPM [resale price maintenance] is inappropriate").

Moreover, because of its overbreadth, the rule of *Dr. Miles* inflicts substantial harm on competitive market processes. In particular, the rule proscribes conduct that, if permitted, would frequently be used for procompetitive purposes and would enhance consumer welfare. In this case, for example, Leegin is a small competitor that used resale price maintenance to provide incentives for retailers to market its products effectively against its larger rivals. The antitrust laws should promote, not condemn, a small manufacturer's efforts to expand its output through aggressive interbrand competition. The *per se* rule against resale price maintenance, however, undercuts this competitive tool and thus undermines interbrand competition—a result that is antithetical to the objectives of the antitrust laws.

This case, which is final in all respects, presents a singularly appropriate vehicle to reconsider the *per se* rule against resale price maintenance, which the Court has not squarely addressed under its modern antitrust jurisprudence. Review

by this Court is necessary to overturn this far-reaching and anachronistic *per se* rule and to bring the law of resale price maintenance into step with the law governing other vertical restraints.

I. THE RULE OF *DR. MILES* IS INCONSISTENT WITH THIS COURT'S MODERN ANTITRUST JURISPRUDENCE.

The *per se* rule against resale price maintenance is the lone remaining vestige of an antiquated antitrust regime that cannot be reconciled with either recent antitrust decisions or economic theory. This Court has abandoned the *per se* rules against other vertical arrangements—including vertical maximum price-fixing arrangements and all types of vertical nonprice restraints. Each of those other *per se* rules—like the rule of *Dr. Miles*—was based on the "ancient rule against restraints on alienation" (*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 380 (1967)), which has no grounding in economics. And each of the other vertical *per se* rules was rejected when the Court applied an approach to antitrust analysis grounded in real-world economics. This Court should reexamine the rule of *Dr. Miles* to resolve the conflict between that outdated and overbroad *per se* rule and the Court's antitrust decisions of the last thirty years.

A. This Court Has Overturned Analogous *Per Se* Rules Against Other Vertical Agreements.

1. Nearly a century ago, this Court in *Dr. Miles* invalidated an agreement that required a manufacturer's dealers to abide by a minimum resale price. Without considering the competitive consequences of the practice, the Court held that these arrangements are invalid under the Sherman Act because such "restraints upon alienation have been generally regarded as obnoxious to public policy." *Dr. Miles*, 220 U.S. at 404. In his dissenting opinion, Justice Holmes rejected the majority's approach and argued that, in many circumstances, the public would "be served best by the company being al-

lowed to carry out its plan" to establish minimum resale prices. *Id.* at 412 (Holmes, J., dissenting).[3]

Following *Dr. Miles*, the Court adopted *per se* rules against other types of vertical restraints. In *Schwinn*, the Court held that vertical nonprice restraints, such as restrictions on the territories or customers that distributors may serve, are *per se* unlawful. 388 U.S. at 379-80. As in *Dr. Miles*, the Court based this *per se* rule on the "ancient rule against restraints on alienation," rather than on economic analysis. *Id.* at 380. The next year, the Court held that vertical maximum price restraints are *per se* unlawful, based on similar concerns for protecting dealer freedom. *See Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968).

When the Court had occasion to reexamine these *per se* rules in light of modern economic analysis, however, it determined that vertical agreements often have procompetitive effects and are therefore more appropriately evaluated on a case-by-case basis under the rule of reason. In *Sylvania*, for example, this Court overturned *Schwinn*'s *per se* rule against vertical nonprice restraints, and expressly rejected the notion that the common-law rule against restraints on alienation could justify a *per se* rule of antitrust liability. *Sylvania*, 433 U.S. at 53 n.21. The Court explained that "the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." *Id.* (internal quotation marks omitted). Instead, "[*p*]*er se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive." *Id.* at 49-50. The Court further explained that *per se* analysis is ill-suited to vertical restrictions "because of their potential for a simultaneous re-

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[3] *See also id.* ("I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get.").

duction of intrabrand competition and stimulation of interbrand competition." *Id.* at 51-52. In light of this potential for procompetitive effects, the Court concluded that the validity of vertical nonprice restraints should be determined under the rule of reason. *Id.* at 58.

Similarly, in *Khan*, this Court unanimously overruled its holding in *Albrecht* that vertical maximum price restraints are *per se* unlawful. As in *Sylvania*, the Court explained that concerns with "dealer freedom" are not an appropriate basis for a *per se* rule of antitrust liability. *Khan*, 522 U.S. at 16-17. Instead, the Court held that *per se* treatment is only "appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Id.* at 10 (internal quotation marks omitted). Building on the critiques of *Albrecht* offered by lower courts and commentators, the Court concluded that the *per se* rule should be rejected because there is "insufficient economic justification for *per se*" treatment of vertical maximum price restraints. *Id.* at 18.

2. The reasoning of this Court's decisions in *Sylvania* and *Khan* severely undermines the rule of *Dr. Miles*. The Court's focus, nearly a century ago, on "restraints on alienation" is no longer a valid basis for a *per se* rule of antitrust law. Instead, a *per se* rule is appropriate *only* for "conduct that would always or almost always tend to restrict competition and decrease output." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (internal quotation marks omitted).

This Court has identified certain prerequisites to application of a *per se* rule in the antitrust context. First, a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *Sylvania*, 433 U.S. at 58-59; *see also Sharp*, 485 U.S. at 724. Second, *per se* treatment is appropriate only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (inter-

nal quotation marks omitted). The Court has thus "expressed reluctance to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.'" *Id.* (quoting *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 458-59 (1986)). As discussed below, the *per se* rule of *Dr. Miles* satisfies neither of these criteria.

B. There Are No Demonstrable Economic Effects That Support *Per Se* Treatment Of Resale Price Maintenance.

In both *Sylvania* and *Khan*, this Court examined the economic effects of the vertical restraints at issue, including by considering "scholarly and judicial authority supporting their economic utility." *Sylvania*, 433 U.S. at 57-58; *see also Khan*, 522 U.S. at 15-19. Based on that examination, the Court found "insufficient economic justification" for *per se* treatment of vertical nonprice and vertical maximum price restraints. *Khan*, 522 U.S. at 18; *see also Sylvania*, 433 U.S. at 57-58. The same result is required in the context of resale price maintenance. Indeed, economic and legal scholars have reached an unusually strong consensus in support of the conclusion that resale price maintenance has a number of procompetitive uses and effects that, if permitted by the antitrust laws, could enhance consumer welfare. *See, e.g.*, ABA Antitrust Section, *Antitrust Law and Economics of Product Distribution* 76 (2006) (the "bulk of the economic literature on RPM . . . suggests that RPM is more likely to be used to enhance efficiency than for anticompetitive purposes").[4]

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[4] *See also* 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1611 (2d ed. 2004); Robert H. Bork, *The Antitrust Paradox* 289 (1978); Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance* 1-5, *at* http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf (forthcoming 2007); Posner, *Antitrust Law*, *supra*, at 172; David A. Butz, *Vertical Price Controls with Uncertain Demand*, 40 J.L. & Econ. 433, 455-57 (1997); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 72

1. Vertical Price And Nonprice Restraints Often Have Procompetitive Effects On Interbrand Competition.

A simplistic—and incorrect—criticism of vertical restrictions (including both price and nonprice restraints) is that they limit intrabrand price competition, raise retailers' margins, often raise retail prices, and are therefore harmful to consumers. That analysis, however, is wrong as a matter of economics and inconsistent with this Court's analysis of vertical restraints.

In *Sylvania*, the Court recognized that manufacturers often use vertical restraints to create incentives for their dealers to provide service and promote the manufacturer's product, which, in turn, fosters interbrand competition:

> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide ser-

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[Footnote continued from previous page]

(1993); Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597, 617 (1993); Frank H. Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 146-48 (1984); Overstreet, *supra*, at 11.

> vice and repair facilities necessary to the efficient marketing of their products.

433 U.S. at 54-55 (citation and footnote omitted). As the Court noted, "these services might not be provided by retailers in a purely competitive situation" because of "market imperfections such as the so-called 'free rider' effect." *Id.* at 55.

In *Sharp*, the Court emphasized that "vertical nonprice restraints only accomplish the benefits" to interbrand competition identified in *Sylvania* "*because they reduce intrabrand price competition* to the point where the dealer's profit margin permits provision of the desired services." *Sharp*, 485 U.S. at 728 (emphasis added). And, as the Court stated in *Sylvania*, interbrand competition is the "primary concern of antitrust law." 433 U.S. at 52 n.19; *see also* Bork, *supra*, at 290; Overstreet, *supra*, at 48.

Moreover, as this Court explained in *Sylvania*, a manufacturer has no interest in overcompensating its retailers by enabling fat retail margins—to the contrary, "a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues." 433 U.S. at 56 n.24. Accordingly, "manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products." *Id.* at 56; *see also* Bork, *supra*, at 290 ("No manufacturer or supplier will ever use either resale price maintenance or reseller market division for the purpose of giving the resellers a greater-than-competitive return. . . . The manufacturer shares with the consumer the desire to have distribution done at the lowest possible cost consistent with effectiveness.").

Notably, a manufacturer uses many tools to enhance its interbrand competitive position that might increase nominal

prices to consumers.[5] Manufacturers may engage in national advertising or upgrade their product features, the costs of which get passed through to consumers in the form of increased prices—yet no one would argue that this conduct in a competitive marketplace is an anticompetitive activity. *See* Elzinga & Mills, *supra*, at 8-9; Easterbrook, *supra*, at 141. The presence of *inter*brand competition assures that manufacturers' actions to promote their products—including vertical distribution restraints—are geared toward efficiency and procompetitive results. *Sylvania*, 433 U.S. at 52 n.19, 56 n.24. If the manufacturer takes actions that boost prices without promotional benefits that consumers desire, it will lose sales to its interbrand competitors. *Id.*; Overstreet, *supra*, at 48. On the other hand, if the manufacturer's sales increase because consumers are getting more services that they value, then consumers benefit. Elzinga & Mills, *supra*, at 9.

Vertical price and nonprice restraints can both be used to enhance interbrand competition in this manner. Indeed, "there is a substantial body of economic analysis supporting the view that the distinction" between vertical price and nonprice restraints "is largely illusory." ABA Antitrust Section, *supra*, at 59; *see also Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) ("the economic effect" of "price and nonprice restrictions" is in many cases "similar or identical"). As Justice White explained in his concurrence in *Sylvania*, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of al-

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[5] While the use of resale price maintenance may lead to higher nominal retail prices, empirical analysis has shown that the practice can, in some situations, actually result in *lower* retail prices, in addition to the proconsumer benefits of increased services stimulated by the practice. *See* Overstreet, *supra*, at 138-40. For example, if resale price maintenance allows a manufacturer to compete more effectively and thereby expand its sales and output, the manufacturer may achieve efficiencies in manufacturing or distribution that could allow it to lower its unit costs and prices. *See id.* at 47-48.

lowing vertical nonprice restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). Indeed, the procompetitive uses of vertical territorial restraints to reduce intrabrand price competition identified by this Court in *Sylvania* and *Sharp* as supporting rule-of-reason treatment are equally applicable to resale price maintenance. *Id.* at 69-70; Posner, *Antitrust Law*, *supra*, at 184 ("any argument for the legitimacy of exclusive territories applies equally to resale price maintenance").

It is thus untenable that resale price maintenance should continue to be treated under a vastly different legal standard than all other vertical restraints. As Judge Bork wrote, "This field of law can be made clear, internally consistent, and congruent with reality only when we face the fact that the premise laid down in *Dr. Miles* . . . is incorrect and must be rejected." Bork, *supra*, at 298. The divergence in treatment of these similar vertical restraints, standing alone, is a strong reason for the Court to reexamine the rule of *Dr. Miles*.

2. There Are Many Uses Of Resale Price Maintenance That Can Enhance Interbrand Competition And Consumer Welfare.

It is well-accepted among legal and economic scholars that resale price maintenance, if permitted by the antitrust laws, would frequently be used for procompetitive purposes, such as providing incentives to retailers to stock and promote the manufacturer's products. *See, e.g.*, Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 81 (1998) ("[P]rice floor restraints are used in most cases unilaterally by a manufacturer to change the mix of price and non-price competition among retailers of its product. Restrictions on distribution are a means of competing on product quality."). "[N]o single specific theory explains all instances of [resale price maintenance]"—instead, there are a number of different purposes for which a manufacturer might implement resale price maintenance that are likely to have procompetitive virtues and en-

hance consumer welfare. Winter, *supra*, at 70. The common thread among these uses is that the manufacturer provides its retailers with a guaranteed margin as a means to enhance its competitive position against interbrand rivals.

The most commonly cited justification for resale price maintenance is that a manufacturer might impose a price floor to ensure that dealers provide demand-creating services. *See, e.g.*, Elzinga & Mills, *supra*, at 3; Overstreet, *supra*, at 49; Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 91 (1960). In the absence of resale price restraints, free-rider problems may diminish retailers' incentives to provide these services, harming the manufacturer and dampening interbrand competition. *See, e.g.*, Posner, *Antitrust Law*, *supra*, at 173.

Even outside the classic free-rider situation, resale price maintenance may be used by a manufacturer to provide its retailers with incentives to compete on service, where the retailer might otherwise have an inherent bias to rely too much on low prices (and not enough on service or promotional activities) to attract customers, which could reduce the manufacturer's overall interbrand competitive position. *See* Winter, *supra*, at 62-64. While a manufacturer might theoretically contract with its retailers to provide certain services, the transaction and monitoring costs associated with such a program can be prohibitive, and it can be far more efficient for a manufacturer to encourage retailers to compete on service by limiting intrabrand price competition. *Id.*

A manufacturer may also use resale price maintenance to encourage retailers to stock its products by guaranteeing a minimum resale margin, essentially "purchas[ing] shelf space in higher cost retail outlets." Overstreet, *supra*, at 47. The ability to "purchase" shelf space through resale price maintenance can be particularly important for a new or small manufacturer trying to break into the marketplace. *See, e.g.*, Mathewson & Winter, *supra*, at 60 ("In markets where extensive distribution systems are necessary, RPM is often used in the early part of a product's life cycle to aid in the estab-

lishment of the distribution system. In this situation, . . . RPM lowers the barriers of entry into upstream markets.").

Similarly, a manufacturer may use resale price maintenance to encourage its retailers to purchase more of its products, particularly in industries in which excess inventory can be subject to heavy discounting (such as the women's fashion industry, in which Leegin competes). Resale price maintenance ensures that retailers will be protected from a dramatic devaluation of their inventory when demand is unexpectedly low and, consequently, it reduces the chance that risk-averse retailers will purchase too little out of concern for having unsold stockpiles at the end of the season. *See, e.g.*, Butz, *supra*, at 451-52. A manufacturer, in turn, might use resale price maintenance to expand output or introduce more innovative products because retailers would be more willing to carry its products, enhancing interbrand competition and benefiting consumers. *Id.* at 457.

3. The Possibility That Resale Price Maintenance Might Be Used By A Cartel Does Not Justify The Rule Of *Dr. Miles*.

Of course, not every use of resale price maintenance is necessarily procompetitive. It is possible, for example, that resale price maintenance (just like vertical territorial restraints) might be used to enforce a horizontal agreement among dealers or manufacturers. *See* Posner, *Antitrust Law*, *supra*, at 183-85. The conditions in which such a cartel might theoretically operate, however, are extremely rare. Elzinga & Mills, *supra*, at 5-6; Easterbrook, *supra*, at 141-43. And, as demonstrated by empirical studies, instances of resale price maintenance being used for procompetitive purposes are "far more common" than instances in which it is used to facilitate a cartel. Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 282 (1991); *see also* Overstreet, *supra*, at 162 (empirical evidence "suggests that neither supplier nor dealer collusion explanations are likely to apply to all or even most instances of price maintenance").

There is neither an empirical nor a theoretical basis to conclude that consumers or competition benefit from a ban on *all* uses of resale price maintenance out of a concern over potential collusive uses of the practice, which could only exist under specific and uncommon market conditions. To the contrary, the empirical evidence "suggest[s] that, on the margin, the dominant effect of a relaxation of the per se prohibition of RPM would be a reduction in the deterrence of non-collusive uses of RPM." Ippolito, *supra*, at 292. Moreover, this Court's precedents do not support applying a *per se* rule that ensnares substantial procompetitive conduct simply out of fear of occasional anticompetitive uses. As discussed above, *per se* rules are appropriate *only* where a practice always, or almost always, results in anticompetitive effects. *See Sharp*, 485 U.S. at 723; Easterbrook, *supra*, at 142-43.

In any event, there is no reason to believe that the existing *per se* rules against horizontal collusion and the methods of detecting and punishing such collusion are so lacking as to justify additional *per se* rules as a prophylactic measure to bolster cartel enforcement. This Court addressed a similar issue in *Sylvania*, in which it noted that "[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers." 433 U.S. at 58 n.28. The Court concluded, however, that "we do not regard the problems of proof as sufficiently great to justify a *per se* rule." *Id.* The same reasoning requires rejection of the argument that a fear of cartels can support a *per se* rule against vertical price restraints.

4. Leegin Used Resale Price Maintenance For Procompetitive Purposes.

The facts of this case powerfully illustrate the competition-enhancing potential of resale price maintenance. Indeed, there is no allegation, evidence at trial, or even a realistic possibility that Leegin's conduct was part of a collusive horizontal scheme. *See* Elzinga Report at 14-18 (App., *infra*, at 31a-35a). There is also no evidence or suggestion that Leegin had market power. To the contrary, Leegin is but a

small player in the fragmented and highly competitive marketplace for women's fashion accessories. *Id.* at 16-20 (App., *infra*, at 33a-37a). In these circumstances, there is no realistic possibility that Leegin's use of resale price maintenance could harm consumers. *See id.* at 26-27 (App., *infra*, at 43a-44a).

Leegin used resale price maintenance in an attempt to bring new products and services to consumers and to use small retailers to compete against prominent national brands sold through department stores and other large outlets. *See* Elzinga Report at 10-12 (App., *infra*, at 27a-29a). This case presents precisely the circumstances in which resale price maintenance can *enhance* interbrand competition and consumer welfare. Indeed, the fact that Leegin's output grew substantially while its pricing policy was in effect indicates strongly that competition was enhanced and that consumers have benefited from the policy. *Id.* at 20 (App., *infra*, at 37a); *see also* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981) ("If [the defendant's] output expanded, the restriction must have made the firm's product more attractive on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition."); Easterbrook, *supra*, at 163-64. Holding Leegin's conduct to be *per se* unlawful stifles the competitive behavior of a small and innovative company, and thus conflicts with the objectives that this Court has sought to promote in interpreting the antitrust laws.

C. There Is No Judicial Experience With Resale Price Maintenance That Could Enable The Court To Predict With Confidence That The Rule Of Reason Will Condemn It.

This Court has often repeated that a *per se* rule is only appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (inter-

nal quotation marks omitted); *see also Broadcast Music, Inc. v. Columbia Broadcast Sys.*, 441 U.S. 1, 20 n.33 (1979). Continued adherence to the *per se* rule against resale price maintenance conflicts with this important criterion for the use of *per se* rules.

The rule of *Dr. Miles* was not the product of judicial experience evaluating resale price maintenance under the rule of reason. Indeed, the *Dr. Miles* Court offered no analysis of the practice's effect on competition or consumers, but instead simply applied the common-law prohibition on "restraints upon alienation." 220 U.S. at 404. And in the nearly 100 years since *Dr. Miles* was decided, the *per se* rule against resale price maintenance has prevented lower courts from developing experience in applying the rule of reason to assess resale price maintenance. *See* Ippolito, *supra*, at 268-69. In this case, for example, the district court conducted no analysis of the competitive effects of resale price maintenance on the marketplace, and it prevented Leegin from introducing any evidence or expert testimony regarding such effects.

Even more significantly, if courts *had* developed experience applying the rule of reason to resale price maintenance, that experience would not have justified a *per se* rule—either at the time of *Dr. Miles* or today. For example, in the late 19th and early 20th centuries, a number of courts evaluated resale price maintenance under the rule of reason and concluded that the practice did *not* harm competition. As the Washington Supreme Court explained:

> In the absence of a monopoly . . . a contract fixing retail prices to the consumer cannot have an effect appreciably inimical to the public interest because it cannot fix prices at an unreasonably high figure without defeating its own purpose by either signally failing to maintain the fixed price, or putting the individual manufacturer out of business. . . . [I]t seems to us an economic fallacy to assume that the competition which, in the absence of monopoly, benefits the public, is

> competition between rival retailers. The true competition is between rival articles . . . .

Fisher Flouring Mills Co. v. Swanson, 137 P. 144, 148, 151 (Wash. 1913).[6]

More recently, this Court has pointed to the procompetitive virtues of vertical agreements that enhance interbrand competition and benefit consumers by limiting intrabrand price competition. As the Court explained in *Sharp*:

> [V]ertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because *they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services*. As we described it in *Monsanto* [*Co. v. Spray-Rite Service Corp.*]: "The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that 'free-riders' do not interfere."

Sharp, 485 U.S. at 728 (quoting *Monsanto*, 465 U.S. at 62-63) (emphasis added). As Justice White recognized in his

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[6] *Accord Grogan v. Chafee*, 105 P. 745, 747 (Cal. 1909) ("There is nothing either unreasonable or unlawful in the effort by a manufacturer to maintain a standard price for his goods. . . . Contracts similar to the one under discussion have been considered in a number of cases, and have generally been upheld . . . ."); *Walsh v. Dwight*, 58 N.Y.S. 91, 93-94 (App. Div. 1899) ("[A] contract by a single manufacturer as to the price at which his goods . . . should be sold . . . would not be a contract by which competition in the supply or price of the commodity would be restrained or prevented. All of the manufacturers could compete with these defendants in the sale of these goods. . . . That such an agreement is not illegal has been settled by a long line of authorities."); *see also* Louis D. Brandeis, *Competition That Kills*, Harper's Weekly, at 11 (Nov. 15, 1913) ("abundant experience establishes that the one-price system . . . [has] greatly increased the efficiency of merchandising, not only for the producer, but for the dealer and the consumer as well").

concurrence in *Sylvania*, this is precisely the same economic effect that is fostered by resale price maintenance, and treating nonprice restraints under the rule of reason thus "call[s] into question" the rule of *Dr. Miles*. *Sylvania*, 433 U.S. at 69-70 (White, J., concurring).[7]

In light of the procompetitive benefits of resale price maintenance—which are the same benefits that motivated the *Sylvania* Court to apply the rule of reason to nonprice restraints—this Court should grant certiorari to reconcile the conflict between *Dr. Miles*'s *per se* prohibition on resale price maintenance and later decisions applying the rule of reason to analogous vertical agreements.

II. THE CONTINUING VITALITY OF THE RULE OF *DR. MILES* IS AN ISSUE OF SUBSTANTIAL PRACTICAL IMPORTANCE.

The question presented in this case has significant real-world economic implications because, contrary to the "primary purpose of the antitrust laws" (*Sharp*, 485 U.S. at 726), the *per se* prohibition against resale price maintenance stifles interbrand competition, and thus harms consumers, in the name of protecting dealer freedom.

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[7] Several lower courts have likewise noted the substantial potential for resale price maintenance to be used for procompetitive purposes, and have questioned the continued *per se* treatment of the practice. *See, e.g.*, *Khan v. State Oil Co.*, 93 F.3d 1358, 1364 (7th Cir. 1996) (noting that the rule of *Dr. Miles* is not "easy to defend in terms of economic theory or antitrust policy"), *rev'd on other grounds*, 522 U.S. 3 (1997); *id.* ("[V]ertical minimum price fixing . . . does not impair any interest that the antitrust laws interpreted in light of modern economics could be thought intended to protect. It increases rather than reduces competition . . . ."); *Pace Elecs., Inc. v. Canon Computer Sys., Inc.*, 213 F.3d 118, 123 n.4 (3d Cir. 2000) (noting that "various scholars have taken issue with the Supreme Court's *per se* treatment of vertical minimum price fixing agreements and argued that these agreements may have significant, procompetitive attributes").

As discussed above, in the absence of the *per se* prohibition on resale price maintenance, manufacturers could use the practice to compete against interbrand rivals. Indeed, the economic literature suggests that resale price maintenance, if permitted by the antitrust laws, would be used with some frequency. *See* Winter, *supra*, at 61 ("up to 10 percent of all retail products in the United States were subject to resale price floors" when state "Fair Trade" laws permitted resale price maintenance); Overstreet, *supra*, at 6-7 (same).

Because of the *per se* rule of *Dr. Miles*, however, manufacturers do not have this competitive tool at their disposal. Instead, they must turn to other restraints to achieve their desired mix of price and service promotion, such as establishing exclusive territories for dealers to prevent free-riding; integrating forward into distribution; or contracting for particular sales-related services. These other tools, however, are not cost-free, and a legal regime that forces businesses to select second-best tools to achieve their competitive ends is inherently inefficient. *See* Posner, *Antitrust Law*, *supra*, at 185; Butz, *supra*, at 443-46, 457; *see also Dr. Miles*, 220 U.S. at 412 (Holmes, J., dissenting) ("The Dr. Miles Medical Company knows better than we do what will enable it to do the best business."). Continued adherence to the rule of *Dr. Miles* thus forces inefficient choices on businesses that would otherwise compete using resale price maintenance. *See* Butz, *supra*, at 447 (in choosing among options to limit control of their distribution systems, manufacturers "have incentives to adopt the lowest-cost approach"). The increased costs from such inefficiency are ultimately borne by consumers.[8]

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[8] It is no cure for the ills of *Dr. Miles* that a manufacturer may unilaterally announce a suggested resale price and terminate noncompliant dealers. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The line between enforcing a unilateral policy and a *per se* illegal agreement can be uncertain. Businesses that rely on *Colgate* run the risk that a jury will later find that they crossed that line, as happened in this case. Moreover, the *Colgate* doctrine is a very blunt instrument. Manufacturers are likely to find it more efficient to enter into an agreement with their dealers that

Moreover, the rule of *Dr. Miles* imposes a particularly heavy burden on the many small businesses or new entrants that would use resale price maintenance to compete against larger incumbents. *See, e.g., Sylvania*, 433 U.S. at 65 (White, J., concurring) ("the potential benefits of vertical restraints in promoting interbrand competition are particularly strong where the manufacturer imposing the restraints is seeking to enter a new market or to expand a small market share"). Smaller competitors—such as Leegin—could use resale price maintenance as a valuable tool to encourage retailers to promote their products. Such companies, however, may be unable to bear the added cost of using less efficient tools to achieve their competitive ends. *See, e.g.*, Butz, *supra*, at 456-57 ("policies designed to promote intrabrand price competition by restricting vertical price controls may force marginally profitable firms out of business, thereby reducing both product variety and interbrand competition"). By contrast, larger competitors may enjoy sufficient brand recognition and clout with retailers that they do not need to employ resale price maintenance; and where they need to enforce minimum resale prices, they may be better suited to bear the increased costs of alternative solutions (such as integrating forward into distribution) that are not subject to *per se* prohibition. *See, e.g.*, Brandeis, *supra*, at 12 ("The great corporation with ample capital . . . can establish its own agencies or sell direct to the consumer, and is in no danger of having its business destroyed by price-cutting among retailers. But the prohibition of price-maintenance imposes upon the small and independent producers a serious handicap.").

A *per se* rule that favors larger incumbents at the expense of smaller competitors, new entrants, and innovators,

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[Footnote continued from previous page]

governs the terms of their relationship, rather than having no option but to terminate noncompliant dealers. It is also ironic that the law now places manufacturers in the position of having to terminate dealers in order to enforce a vertical restraint that is designed to enhance retail services.

and that pushes manufacturers to integrate forward into distribution rather than use independent distributors, is antithetical to any rational principle of antitrust law.

III. THE ARGUMENTS FOR RETAINING THE RULE OF *DR. MILES* ARE INSUFFICIENT TO JUSTIFY ITS CONTINUED EXISTENCE.

In the lower courts, PSKS argued for retaining the rule of *Dr. Miles* based on considerations of *stare decisis* and deference to various congressional actions (or inactions) that did not actually require continued *per se* treatment of resale price maintenance. This Court has previously rejected similar arguments in overturning analogous *per se* rules, and it should not allow these considerations to stand in the way of a long-overdue reexamination of the rule of *Dr. Miles*.

A. *Stare Decisis* Is Not A Basis For Leaving Outdated *Per Se* Rules In Place.

In *Khan*, this Court expressly rejected the argument that it should leave undisturbed the antiquated and economically unsound *per se* rule against vertical maximum price restraints based on considerations of *stare decisis*. 522 U.S. at 20-21. The Court explained that "*stare decisis* is not an inexorable command" and that, "[i]n the area of antitrust law, there is a competing interest, well-represented in this Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Id.* Similarly, in *Sharp*, the Court recognized that "[t]he Sherman Act adopted the term 'restraint of trade' along with its dynamic potential," and therefore the "line of *per se* illegality" should not "remain[] forever fixed where it was" when the Sherman Act was enacted in 1890. 485 U.S. at 732.

This understanding of the dynamic nature of the Sherman Act is faithful to Congress's intent, and it has been an important part of the Court's antitrust jurisprudence for well over a century. *See, e.g.*, 21 Cong. Rec. S2456-60 (daily ed. Mar. 21, 1890) (statement of Sen. Sherman) (noting that the courts should "determine in each particular case" the "precise

line between lawful and unlawful combinations").[9] Indeed, in *Dr. Miles* itself, the Court stated that, "[w]ith respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions." 220 U.S. at 406; *accord Khan*, 522 U.S. at 21. Nothing in the Sherman Act or the history of this Court's decisions requires that the "adaptation to modern conditions" be frozen in place in 1911.

B. Congress Has Never Required Adherence To The Rule Of *Dr. Miles*.

In the lower courts, PSKS placed heavy reliance on arguments that the *per se* rule of *Dr. Miles* should be retained because of various actions or inactions by Congress over the course of the last century. This argument, however, provides no basis to refrain from reexamining the rule of *Dr. Miles* in light of modern economic understanding.

Congress's failure to legislatively overturn the rule of *Dr. Miles* warrants little weight. Indeed, this Court expressly rejected an argument based on congressional inaction in *Khan*, stating that "we infer little meaning from the fact that Congress has not reacted legislatively to *Albrecht*." 522 U.S. at 19. The Court explained that "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted

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[9] *See also, e.g., Guardians Ass'n v. Civil Serv. Comm'n*, 463 U.S. 582, 641 n.12 (1983) (Stevens, J., dissenting) ("Congress phrased some older statutes in sweeping, general terms, expecting the federal courts to interpret them by developing legal rules on a case-by-case basis in the common law tradition. One clear example of such a statute is the Sherman Act. For that reason, in [*Sylvania*], the doctrine of *stare decisis* did not preclude the Court from overruling its prior decision in [*Schwinn*], even though Congress had not acted in the intervening decade." (citations omitted)); *Tex. Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1981) (Congress's intent in passing the Sherman Act "to allow courts to develop governing principles of law [is] unmistakably clear"); Easterbrook, *supra*, at 136-38.

view that Congress expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition." *Khan*, 522 U.S. at 20 (internal quotation marks omitted).[10]

The proper focus is not on any "inaction" by Congress, but whether Congress has taken any action to take away from this Court its traditional role of "giv[ing] shape to the [Sherman Act's] broad mandate" in light of "the lessons of accumulated experience." *Khan*, 522 U.S. at 20. Congress has not taken such action with respect to resale price maintenance. In particular, Congress has *never* passed legislation requiring that resale price maintenance be treated as *per se* unlawful. To be sure, resale price maintenance has been a subject of congressional action on several occasions. In 1937 and 1952, Congress passed legislation that removed resale price maintenance contracts from the reach of the Sherman Act if such contracts were valid under state laws. *See* Miller-Tydings Act, Pub. L. No. 75-314, 50 Stat. 693 (1937); McGuire Act, Pub. L. No. 82-542, 66 Stat. 631 (1952). In 1975, Congress repealed these acts. *See* Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801. The 1975 Act did *not*, however, require that resale price maintenance be deemed *per se* unlawful. Congress simply repealed an antitrust exemption and restored the ordinary state of antitrust law—judicial interpretation of what constitutes an unlawful "restraint of trade." *See* Posner, *Antitrust Law*, *supra*, at 189 ("Congress's action in repealing an antitrust immunity for resale price maintenance was not the same thing as outlawing the practice."); Easterbrook, *supra*, at 139-40. This legislation provides no basis to freeze in place the *per se* rules that existed in 1911, 1975, or any other year.

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[10] *See also Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978) ("Congress . . . did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.").

In the courts below, PSKS also pointed to a handful of additional measures that Congress has considered or passed in the last three decades; but, again, none of these measures limits this Court's mandate to determine what conduct constitutes an unlawful restraint of trade. For example, in the mid-1980s, Congress twice prohibited the Department of Justice from using appropriations to advocate for a reversal of the *per se* rule against resale price maintenance. *See* Pub. L. No. 99-180, 99 Stat. 1136 (1985); Pub. L. No. 98-166, 97 Stat. 1102 (1983). The appropriation provisions were not repeated in the next budget, and they have not been repeated since. That these budgetary restrictions were not renewed, and that no similar restraints have been in place for a number of years, suggests, if anything, that Congress deemed them undesirable after the short period in which they were in place. This hardly seems to be a basis to disrupt this Court's longstanding mandate to interpret the Sherman Act.

That Congress has not enacted legislation that would take away this Court's power to interpret the antitrust laws simply underscores the propriety of the approach to the Sherman Act that this Court has pursued for a century. As Chief Justice White wrote in the year that *Dr. Miles* was decided, the Court should continue to interpret the standards for what constitutes an unlawful restraint of trade as its understanding of what makes a restraint "unreasonable" evolves. *Standard Oil Co. v. United States*, 221 U.S. 1, 63-64 (1911).

IV. AT A MINIMUM, RESALE PRICE MAINTENANCE BY A MANUFACTURER WITH NO MARKET POWER SHOULD BE SUBJECT TO THE RULE OF REASON.

Even if this Court were to conclude that resale price maintenance should continue to be treated as *per se* unlawful under some circumstances, it should grant certiorari to reject the rigid, sweeping *per se* rule applied by the lower courts in this case. In particular, if the Court were to conclude that a concern over the anticompetitive effects of horizontal collusion were a sound basis to maintain some form of *per se* rule

against resale price maintenance—which we believe would be unjustified (*see supra* Section I.B.3)—such a *per se* rule should be limited to apply only where there is a clear likelihood of such anticompetitive effects. *See, e.g., Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 298 (1985) ("A plaintiff seeking application of the *per se* rule [against group boycotts] must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects.").

For example, the Court has limited the *per se* rules against group boycotts and tying arrangements to cases in which the defendants possess market power, because in the absence of market power, the conclusion that the practices are "virtually always likely to have an anticompetitive effect is not warranted." *Id.* at 296; *see also Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16-18 (1984). In contrast, the lower courts in this case applied the *per se* rule against resale price maintenance blindly, with no regard for the actual marketplace impact, no analysis whether Leegin had market power, no inquiry into Leegin's rationale for the practice, and no opportunity for Leegin to explain the procompetitive consequences of its actions. *See* App., *infra*, at 15a.

While the most appropriate treatment of the *per se* rule of *Dr. Miles* would be to overturn it in its entirety, at a minimum this Court should make clear that the *per se* rule should not apply where a plaintiff is unable to "present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects." *Nw. Wholesale*, 472 U.S. at 298. In particular, the economic community has reached a clear consensus that there is no realistic possibility that resale price maintenance instituted by a manufacturer without market power and without horizontal collusion could have anticompetitive effects.[11]

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[11] *See, e.g.*, Overstreet, *supra*, at 174-75 ("Firms with small market shares are unlikely to possess market power, and they are, therefore, unlikely to be able unilaterally to employ RPM with anticompetive [sic]

In this case, Leegin is a small manufacturer with no market power in an intensely competitive marketplace, and there is no allegation of horizontal collusion or of market conditions that would make collusion likely. There is simply no realistic threat that its use of resale price maintenance could have had anticompetitive effects. Thus, even under a more economically tenable and narrowed *per se* rule, Leegin's policy should have been evaluated under the rule of reason. Accordingly, the Court should grant this petition to reassess the lower courts' application of the *per se* rule against resale price maintenance—if such a *per se* rule should be deemed appropriate at all.

V. THIS CASE IS AN IDEAL VEHICLE THROUGH WHICH TO RECONSIDER THE RULE OF *DR. MILES*.

Despite the broad impact of the rule of *Dr. Miles*, this case presents a rare opportunity for this Court to address these issues. Indeed, because of the longstanding *per se* prohibition on resale price maintenance, most manufacturers avoid entering into such agreements with their dealers, even where the practice would be the most efficient means to achieve their competitive ends.

Moreover, when a manufacturer is accused of entering into a resale price maintenance agreement, there are powerful

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[Footnote continued from previous page]

effects. Unless there is evidence . . . from which some inference of supplier collusion seems proper, a presumption that a firm with small market share is motivated to impose RPM by efficiency considerations is probably correct."); Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 Antitrust L.J. 83, 103 (1995) (where a small firm uses vertical restraints, there is "a strong case for use of vertical restraints because anticompetitive risks are low and alternative promotion techniques are unavailable"); Easterbrook, *supra*, at 159 ("if the defendant lacks market power, other firms can offer the customer a better deal, and there is no need for judicial intervention").

incentives for the manufacturer to settle the litigation because such cases present asymmetrical risks and rewards for the defendant, which may be defending its entire distribution system, and a plaintiff retailer, which may have nothing more at stake than damages in the litigation. Consistent with these incentives, empirical studies have demonstrated that a high percentage of resale price maintenance cases settle before conclusion. *See* Ippolito, *supra*, at 267, 273-74. This petition accordingly presents a rare opportunity for this Court to reexamine the rule of *Dr. Miles*.

Just as importantly, this case squarely presents the issue to this Court. Based on the *per se* rule of *Dr. Miles*, the district court prevented Leegin from presenting evidence of the procompetitive effects of its pricing policies, including the testimony of Leegin's economic expert. In addition, the district court instructed the jury, over Leegin's objection, that Leegin's pricing practices were *per se* unlawful, and it denied Leegin's motion for judgment as a matter of law based on the same conclusion. Leegin would clearly be entitled to a reversal if this Court overturned the rule of *Dr. Miles*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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October 4, 2006

APPENDIX

APPENDIX A

United States Court of Appeals,
Fifth Circuit.
PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes; Toni Cochran L.L.C., doing business as Toni's,
Plaintiffs-Appellees,

v.

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Defendant-Appellant.

No. 04-41243.

Decided March 20, 2006.

David Neil Smith, Nix, Patterson & Roach, Daingerfield, TX, Robert W. Coykendall, Ken M. Peterson, Morris, Laing, Evans, Brock & Kennedy, Wichita, KS, for Plaintiffs-Appellees.

Jeffrey Scott Levinger, Carrington, Coleman, Sloman & Blumenthal, Dallas, TX, Tyler Alexander Baker, III, G. Aaron Myers, Fenwick & West, Mountain View, CA, for Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Texas, (2:03-CV-107-TJW).

Before BARKSDALE and CLEMENT, Circuit Judges, and ENGELHARDT, District Judge.*

PER CURIAM:**

Leegin Creative Leather Products, Inc., primarily challenges application of the antitrust *per se* rule to its imposing a vertical minimum price-fixing agreement on its retailer, PSKS, Inc., doing business as Kay's Kloset . . . Kay's Shoes. Among other issues is the awarded damages' evidentiary basis. **AFFIRMED.**

I.

In 1995, Leegin, manufacturer of Brighton women's accessories, began selling its products to PSKS, a women's clothing and accessories specialty store. PSKS invested heavily in advertising and promoting the Brighton brand; by 1999, Brighton was PSKS' best-selling and most profitable line.

In 1997, Leegin instituted the "Brighton Retail Pricing and Promotion Policy", stating it would do business only with retailers following its suggested retail prices for Brighton products. In doing so, Leegin made clear it would not do business with retailers who engaged in discounting Brighton products they intended to reorder.

Leegin subsequently introduced the "Heart Store Program", a new marketing initiative designed to provide incentives to certain Brighton retailers to promote the brand within a separate section of their stores. To become a Brighton Heart Store, retailers had to pledge to "[f]ollow the Brighton Suggested Pricing Policy at all times".

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* District Judge of the Eastern District of Louisiana, sitting by designation.

** Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

In late 2002, after learning PSKS had violated Leegin's pricing policy by placing PSKS' entire line of Brighton products on sale, Leegin suspended all shipments of Brighton products to PSKS. As a result, its sales and profits decreased substantially.

PSKS filed this action against Leegin under § 1 of the Sherman Antitrust Act, 15 U.S.C. § 1: (1) claiming it entered into illegal agreements with retailers to fix Brighton products' prices and terminated PSKS as a result of those agreements; and (2) seeking future-lost-profits damages. (Co-plaintiff Toni Cochran, L.L.C.'s claims were dismissed at the close of plaintiffs' evidence. Cochran did not appeal.)

The jury found: Leegin and its retailers agreed to fix the retail prices of Brighton products; this caused PSKS to suffer antitrust injury; and PSKS was entitled to damages of $1.2 million. Pursuant to 15 U.S.C. § 15(a), the district court trebled the damages and awarded attorney's fees. Post-judgment, Leegin renewed its motion for judgment as a matter of law and moved for a new trial. The motions were denied.

II.

Leegin does *not* challenge the jury's finding it entered into price-fixing agreements. Instead, it challenges, *inter alia*, the application of the *per se* rule and the damages' evidentiary basis.

A.

Leegin claims the rule of reason should apply to PSKS' antitrust claims. This issue of law is reviewed *de novo*. *Craftsmen Limousine, Inc. v. Ford Motor Co.*, 363 F.3d 761, 772 (8th Cir. 2004) ("[A]lthough a court's determination that the *per se* rule applies might involve many fact questions, the selection of a mode [of analysis] is entirely a question of law.") (alteration in original; internal citation and quotation marks omitted). Each of the following three challenges fails.

1.

Leegin asserts: although the Supreme Court first applied the *per se* rule to vertical price fixing in *Dr. Miles Medical*

Co. v. John D. Park & Sons Co., 220 U.S. 373, 31 S.Ct. 376, 55 L.Ed. 502 (1911), it has not applied the rule consistently. The cases cited by Leegin in which the Court applied the rule of reason, however, did *not* involve a vertical minimum price-fixing agreement. *See State Oil Co. v. Khan*, 522 U.S. 3, 118 S.Ct. 275, 139 L.Ed.2d 199 (1997) (considering the validity of the *per se* rule against a vertical *maximum* price-fixing agreement); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 108 S.Ct. 1515, 99 L.Ed.2d 808 (1988) (applying the rule of reason to a vertical agreement that had the purpose and effect of increasing retail prices, but *without specifying the price to be charged*); *Cont'l T. V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977) (rejecting the *per se* rule for a vertical *non-price* restriction).

Because the Court has consistently applied the *per se* rule to such agreements, we remain bound by its holding in *Dr. Miles Medical Co. See also Simpson v. Union Oil Co. of Cal.*, 377 U.S. 13, 17, 84 S.Ct. 1051, 12 L.Ed.2d 98 (1964) ("[A] supplier may not use coercion on its retail outlets to achieve resale price maintenance".); *United States v. Parke, Davis & Co.*, 362 U.S. 29, 44, 80 S.Ct. 503, 4 L.Ed.2d 505 (1960) ("When the manufacturer's actions . . . go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices, . . . he has put together a combination in violation of the Sherman Act."). In *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 769, 104 S.Ct. 1464, 79 L.Ed.2d 775 (1984) (Brennan, J., concurring), Justice Brennan commented on the Court's continued application of the *per se* rule, consistent with congressional intent, to distributor-termination cases in which there is a concerted action to set prices:

> As the Court notes, the Solicitor General has filed a brief . . . urging us to overrule the Court's decision in *Dr. Miles Medical Co.* . . . . That decision has stood for 73 years, and Congress has certainly been aware of its exis-

> tence throughout that time. Yet Congress has never enacted legislation to overrule the interpretation of the Sherman Act adopted in that case. Under these circumstances, I see no reason for us to depart from our longstanding interpretation of the Act.

2.

In the alternative, Leegin claims: its pricing policy did *not* result in competitive harm; therefore, it qualifies for an exception to the *per se* rule. Leegin asserts both the Supreme Court and this court have recognized exceptions to the rule's application in appropriate cases, citing *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 99 S.Ct. 1551, 60 L.Ed.2d 1 (1979); *Abadir & Co. v. First Mississippi Corp.*, 651 F.2d 422 (5th Cir. Unit A July 1981); and *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351 (5th Cir. 1980).

As before, none of these cases involved vertical minimum price fixing. Furthermore, each was decided *before* the Court reaffirmed the *per se* rule's application to vertical minimum price-fixing agreements in *Sharp Electronics Corp.*, *Spray-Rite Service Corp.*, and *Khan*, as discussed *supra*.

3.

Leegin challenges the exclusion of its economic expert, who opined: (1) economic conditions did *not* dictate the *per se* rule's application; and (2) Leegin's pricing practices were pro-competitive, justifying the rule of reason's application. We review for abuse of discretion. *Watkins v. Telsmith, Inc.*, 121 F.3d 984, 988 (5th Cir.1997) ("District courts enjoy wide latitude in determining the admissibility of expert testimony, and the discretion of the trial judge and his or her decision will not be disturbed on appeal unless manifestly erroneous.") (internal citations and quotation marks omitted).

With the *per se* rule, expert testimony regarding economic conditions and the pricing policy's pro-competitive

effects is *not* relevant. *Viazis v. Am. Ass'n of Orthodontists*, 314 F.3d 758, 765 (5th Cir.2002) ("If application of the *per se* rule is appropriate, competitive harm is presumed, and further analysis is unnecessary."), *cert. denied*, 538 U.S. 1033, 123 S.Ct. 2078, 155 L.Ed.2d 1063 (2003); *see also N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5, 78 S.Ct. 514, 2 L.Ed.2d 545 (1958) ("[The] principle of *per se* unreasonableness . . . avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved . . . in an effort to determine . . . whether a particular restraint has been unreasonable".)

B.

Leegin claims PSKS did *not* prove antitrust injury, maintaining it is required under both the *per se* rule and the rule of reason. *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 341-42, 110 S.Ct. 1884, 109 L.Ed.2d 333 (1990). Because antitrust injury *vel non* is a component of standing, we review *de novo*. *DeLong Equip. Co. v. Wash. Mills Electro Minerals Corp.*, 990 F.2d 1186, 1194 (11th Cir.), *cert. denied*, 510 U.S. 1012, 114 S.Ct. 604, 126 L.Ed.2d 569 (1993); *see also Doctor's Hosp. of Jefferson, Inc. v. Se. Med. Alliance, Inc.*, 123 F.3d 301, 305 (5th Cir.1997) ("Antitrust injury must be established for the plaintiff to have standing under section 1 . . . of the Sherman Act.").

1.

Antitrust "injury . . . [is what] the antitrust laws were intended to prevent and . . . flows from that which makes defendants' acts unlawful". *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977). "It ensures that the harm claimed . . . corresponds to the rationale for finding a violation of the antitrust laws in the first place." *Atl. Richfield Co.*, 495 U.S. at 342, 110 S.Ct. 1884.

In *Doctor's Hospital of Jefferson, Inc.*, 123 F.3d at 305, our court explained: "[A]ntitrust injury for standing purposes should be viewed from the perspective of the plaintiff's position in the marketplace, not from the merits-related per-

spective of the impact of a defendant's conduct on overall competition". Thus, antitrust injury is distinct from injury to competition, "the latter of which is often a component of substantive liability". *Id.*

PSKS suffered antitrust injury. Its refusal to follow Leegin's pricing policy resulted in inability to obtain its best-selling and most profitable product line. *See Pace Elecs., Inc. v. Canon Computer Sys., Inc.*, 213 F.3d 118, 124 (3d Cir. 2000) ("[A] dealer terminated for its refusal to abide by a vertical minimum price fixing agreement suffers antitrust injury and may recover losses flowing from that termination".).

2.

In the alternative, Leegin claims the district court erred by failing to instruct the jury on the definition of antitrust injury. Because such injury is a component of standing for the court's determination, this claim necessarily fails. *See Bell v. Dow Chem. Co.*, 847 F.2d 1179, 1182 (5th Cir. 1988) ("Antitrust injury is a component of the standing inquiry, not a separate qualification.").

C.

The jury awarded approximately 70 percent of the requested damages: $1.2, of the requested $1.7, million. Leegin contests the damages' evidentiary basis. The jury's award of antitrust damages is reviewed under a relaxed standard. *Bell Atl. Corp. v. AT & T Corp.*, 339 F.3d 294, 303 (5th Cir. 2003) ("[T]he nature of an antitrust claim means that some plaintiffs can only hypothesize about what the state of their affairs would have been absent the wrong . . . and we have, therefore, declined to hold antitrust plaintiffs to the same burden of proof of damages as demanded of plaintiffs in other civil cases".) (internal citations and quotation marks omitted); *Park v. El Paso Bd. of Realtors*, 764 F.2d 1053, 1067 (5th Cir. 1985) ("Once a plaintiff has proved by a preponderance of the evidence the fact of injury, a jury may use its discretion in determining the exact amount of damages resulting from the antitrust violation."), *cert. denied*, 474 U.S. 1102, 106 S.Ct. 884, 88 L.Ed.2d 919 (1986); *Malcolm v.*

Marathon Oil Co., 642 F.2d 845, 864 (5th Cir. Unit B Apr.) ("The relaxation of standards of proof are *particularly appropriate* in cases where the finder of fact *must estimate lost future profits*.") (emphasis added), *cert. denied*, 454 U.S. 1125, 102 S.Ct. 975, 71 L.Ed.2d 113 (1981).

In calculating damages, PSKS' expert averaged the gross profits PSKS earned from selling Brighton products in 2000 ($289,516), 2001 ($201,591), and 2002 ($141,458), concluding it would lose an estimated $210,855 in gross profits each year. (The decline in gross profits during 2001 and 2002 was attributed to: the 11 September 2001 terrorist attacks; and problems obtaining Brighton products in 2002.) That amount was multiplied by ten, the number of years PSKS' co-owner estimated it would take PSKS to recover from the termination of Brighton shipments, particularly because of the line's uniqueness. As discussed *infra*, PSKS offered evidence that net profits were the same as gross profits; the total was discounted to present value. Leegin did *not* offer an alternative method for calculating damages. *See Greene v. Gen. Foods Corp.*, 517 F.2d 635, 665 (5th Cir. 1975) (noting defendant's failure "to demonstrate any better method of lost future profits that could have been applied to the available data"), *cert. denied*, 424 U.S. 942, 96 S.Ct. 1409, 47 L.Ed.2d 348 (1976).

Obviously, it is impossible to prove PSKS' exact profits had Leegin not terminated its Brighton shipments. Instead, PSKS presented expert testimony, which "provide[d] a 'just and reasonable estimate of the damage based on relevant data.'" *Bell Atl. Corp.*, 339 F.3d at 303 (quoting *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264, 66 S.Ct. 574, 90 L.Ed. 652 (1946)). Accordingly, pursuant to our relaxed standard of review, each of the following four challenges fails.

1.

Leegin challenges the ten-year future-damages period. The expert relied on the above-referenced testimony that: it took PSKS ten years to find Brighton; the business grew very fast once that line was incorporated; and ten years was the

absolute minimum it would take PSKS to recover from the line's termination. This testimony by PSKS' co-owner was based on his 17-years experience building a profitable business.

The damages period is an issue for the jury. *Lehrman v. Gulf Oil Corp.*, 464 F.2d 26, 47 (5th Cir.) ("The duration of the period during which plaintiff might be expected to profit will vary from case to case; it is susceptible of no precise formulation, and must be left to the processes of the jury informed by the presentation of conflicting evidence."), *cert. denied*, 409 U.S. 1077, 93 S.Ct. 687, 34 L.Ed.2d 665 (1972).

2.

Leegin claims insufficient evidence for the lost net-profits calculation. In this regard, PSKS utilizes a point-of-sale system to track the direct costs and selling price of its inventory, allowing it to access information by an individual product or product line. PSKS' co-owner used this system to determine Brighton's contribution to PSKS' net profits during the three years prior to the termination, basing his projections on the average net profits during those three years. In doing so, he did *not* project any sales growth, despite testimony that the retail stores to which Leegin sold in 2003 experienced a 16-percent increase in revenues. Also, he did *not* consider profits from cross sales to customers who came to the store to purchase Brighton goods. Further, he testified gross and net profits were the same in this instance, because PSKS did not save costs as a result of its loss of the Brighton line.

Our court has approved future-profits estimates based on averages of past history. *See Malcolm*, 642 F.2d at 859-60. As noted, although PSKS' average profits from Brighton declined during the three years considered, this decline was attributed to the events of 11 September 2001 and PSKS' difficulty in obtaining Brighton products in 2002.

3.

Leegin maintains the damages model failed to account for mitigation of damages. It asserts PSKS profitably sold substitute products shortly after it lost the Brighton line. Leegin's representative, however, testified that, as early as 1998, she saw lines of handbags, shoes, and belts that competed with Brighton products.

The mere presence of competing products does *not* show they were substitutes for the Brighton line, or that their sale mitigated PSKS' loss. Its continued business of selling women's clothing and accessories, some of which are similar to the Brighton line, does not negate the lost profits incurred from its inability to sell Brighton products. *See Bhan v. NME Hosps., Inc.*, 669 F. Supp. 998, 1014 (E.D. Cal. 1987) (recognizing that providing an antitrust violator with immunity simply because the victim mitigated damages would contravene the goal of limiting anticompetitive conduct), *aff'd*, 929 F.2d 1404 (9th Cir.), *cert. denied*, 502 U.S. 994, 112 S.Ct. 617, 116 L.Ed.2d 639 (1991).

4.

Finally, Leegin claims the damages model impermissibly utilized a risk-free discount rate for the present-value award. "[T]he selection of a discount factor is a question of fact to be determined by the trier of fact". *Bridas S.A.P.I.C. v. Gov't of Turkmenistan*, 345 F.3d 347, 364 (5th Cir. 2003) (internal citations and quotation marks omitted), *cert. denied*, 541 U.S. 937, 124 S.Ct. 1660, 158 L.Ed.2d 357 (2004).

The jury was properly instructed to award only the present value of future damages. It heard testimony, including on cross-examination, regarding the rate utilized.

III.

For the foregoing reasons, the judgment is **AFFIRMED;** attorney's fees and expenses incurred for this appeal are **AWARDED** PSKS, pursuant to 15 U.S.C. § 15(a). This case is **REMANDED** to determine that amount.

AFFIRMED; ATTORNEY'S FEES and EXPENSES AWARDED FOR APPEAL; REMANDED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
MARSHALL DIVISION

PSKS, INC., ET AL.	§	
Vs.	§	CIVIL ACTION NO. 2:03-CV-107
LEEGIN CREATIVE LEATHER PRODUCTS, INC.	§	

ORDER

The defendant's motion for new trial (#108) and renewed motion for judgment as a matter of law (#109) are denied.

In the motion for new trial, the defendant contends that the court erred when it excluded the testimony of its economic expert. Despite the defendant's arguments, the court remains persuaded that its analysis of this case and, in particular, the rationale underlying the court's exclusion of Dr. Elzinga's testimony, is correct under current law. Nearly a century ago, *Dr. Miles* prescribed vertical minimum price fixing agreements unlawful under Section 1. *Dr. Miles Medical Co. v. John D. Park & Co.*, 220 U.S. 373 (1911). Whether the per se classification of such agreements is wise is not for this court to decide. A dealer terminated for discounting under the circumstances presented here suffers antitrust injury as a matter of law. *Pace Electronics, Inc. v. Canon Computer Systems, Inc.*, 213 F.3d 118, 124 (3d Cir. 2000). The defendant's arguments that the court should have

further defined antitrust injury or that a defense existed because the plaintiff could not prove injury to competition are indirect challenges to the per se classification of the violation. In addition, the court is not persuaded that the jury should have been instructed under *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1361-1367 (5th Cir. 1980) that it could find an exception to the per se rule under the facts of this case. The court has canvassed the arguments made in the defendant's motion for new trial and is persuaded that the motion should be denied.

The court has also considered the arguments made in the defendant's renewed motion for judgment as a matter of law. To evaluate the motion for judgment as a matter of law, the court must keep in mind that the jury in this case found a violation of Section 1 on sufficient evidence. That said, the defendant's primary challenge is to the evidence supporting the damages verdict. The defendant contends that the plaintiff's damage model and supporting proof were impermissibly speculative. The court disagrees.

In an antitrust case, once the fact of damages has been proven, a plaintiff enjoys a somewhat relaxed burden of proof regarding the amount of damages. *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264 (1946). This is because it is not possible to compute future damages with mathematical precision and the wrongdoer should bear the burden of any uncertainty created by the illegal activity. *Story Parchment Company v. Paterson Parchment Paper Company*, 282 U.S. 555 (1931); *Lehrman v. Gulf Oil Corporation*, 464 F.2d 26, 46 (5th Cir. 1972) ("the courts are to take a charitable view of the difficulties of proving damages in a case when a treble-damage plaintiff must try to prove what would have accrued to him in the absence of the defendant's anticompetitive practice."). In a distributor termination case, the defendant's decision to cut off the source of supply forces an aggrieved plaintiff who seeks compensation for lost profits, in effect, to prove sales that he never had a chance to make. *Pierce v. Ramsey Winch Co.*, 753 F.2d 416, 435 (5th Cir. 1985). Although the standard is lenient, it is not without

limits: the plaintiff must not resort to guesswork or speculation. Instead, a plaintiff must provide a just and reasonable estimate of the damage based on relevant data. *Eleven Line, Inc. v. North Texas State Soccer Ass'n*, 213 F.3d 198, 206-07 (5th Cir. 2000).

Here, there is no substantial question that the plaintiff proved the fact of damages resulting from the termination of its supply. The defendant touts the Brighton brand as an attractive, unique product, made so at least in part by the company's pricing policies. The value of such a brand to a distributor is evident. Even when undertaken pursuant to the *Colgate* doctrine, one intended effect of suspending shipments to a dealer is to cause adverse economic consequences--to persuade, as the case may be, the discounter to reconsider its position. So it was in this case. The plaintiff proved the fact of damages.

As to the amount of damages, the court has reviewed the evidence under the prevailing standards and concludes that the jury could have credited or rejected the factual underpinnings of Mr. Davis's testimony, including the projected damages term and the benchmark average used to compute the subsequent annual losses. The average sales in particular were based on actual, not theoretical, numbers. Mitigation was also for the jury. The defendant's able lawyers subjected the plaintiff's principal and its expert witness to vigorous cross-examination on the merits of the damages issues in this case. The jury was properly instructed on the measure of damages, and it is significant that the jury did not award the entire amount sought by the plaintiff. Under the prevailing standards for antitrust damages, this award is supported by sufficient evidence. The court has reviewed the balance of the renewed motion for judgment as a matter of law and concludes that the motion should be denied.

So **ORDERED** and **SIGNED** this 17th day of August, 2004.

/s/

T. JOHN WARD
UNITED STATES DISTRICT JUDGE

APPENDIX C

U.S. Court of Appeals
FILED
July 19, 2006
Charles R. Fulbruge III
Clerk

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 04-41243

PSKS INC doing business as, Kay's Kloset . . . Kay's Shoes;
TONI COCHRAN LLC doing business as, Toni's

Plaintiffs - Appellees

v.

LEEGIN CREATIVE LEATHER PRODUCTS INC

Defendant - Appellant

Appeal from the United States District Court for the
Eastern District of Texas, Marshall

ON PETITION FOR REHEARING
AND REHEARING EN BANC

(Opinion 3/20/06, 5 Cir., _____, _____ F.3d _____)

Before BARKSDALE and CLEMENT, Circuit Judges, and ENGELHARDT, District Judge*.

PER CURIAM:

(X) The Petition for Rehearing is DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on Rehearing En Banc, (FED. R. APP. P. and 5TH CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) The Petition for Rehearing is DENIED and the court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor, (FED. R. APP. P. and 5TH CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service and not disqualified not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/

United States Circuit Judge

REHG-4A

* District Judge of the Eastern District of Louisiana, sitting by designation.

APPENDIX D

An Economic Analysis of the Antitrust Issues in:

PSKS, Inc. d/b/a/ Kay's Kloset, Kay's Shoes; and Toni Cochran, L.L.C., d/b/a/ Toni's

v.

Leegin Creative Leather Products, Inc.

before Judge T. John Ward
U.S. District Court for the Eastern District of Texas, Marshall Division
Civil Action No. 2-03-CV-107-TJW

Report of Kenneth G. Elzinga
Professor of Economics
University of Virginia

January 12, 2004

I. Introduction and Personal Background

I am the Robert C. Taylor Professor of Economics at the University of Virginia. Most of my teaching and research is in the field of antitrust economics. This report represents my economic analysis of the antitrust issues in *PSKS, Inc. d/b/a/ Kay's Kloset, Kay's Shoes; Toni Cochran, L.L.C., d/b/a/ Toni's v. Leegin Creative Leather Products, Inc* (hereafter Kay's, Toni's, Leegin). I have served in the Antitrust Division of the Department of Justice at the policy level and have lectured on several occasions to federal judges on antitrust economics. Currently I am a consultant to both the Antitrust Division and the Federal Trade Commission on major antitrust matters. I have been a testifying expert on antitrust cases that have gone to appellate courts, including the Supreme Court, and I have authored and co-authored dozens of scholarly publications on the economics of antitrust. Re-

cently I served as a special consultant to Judge Lewis A. Kaplan in the Christie's-Sotheby's Auction Houses Antitrust Litigation and I have been on the faculty for several years of the American Law Institute-American Bar Association course on Product Distribution and Marketing.

A copy of my curriculum vitae is attached as Exhibit 1. A list of the cases in which I have provided testimony in recent years is provided as Exhibit 2.

II. Assignment in this Case

I was asked by attorneys representing Leegin to conduct an economic analysis of the allegations made by the plaintiffs in this antitrust case. Plaintiffs claim that Leegin's Suggested Retail Price policy on its Brighton line of products affords Leegin "vertical pricing control to monopolize the market" and that the effect of Leegin's price policy is to "penalize the consumers of goods." In short, plaintiffs accuse Leegin of adopting and implementing a business model that "reduces competition." (Complaint, ¶14)

To carry out this assignment, my research was conducted at two general levels. The first involved understanding the economics of women's fashion accessories such as handbags, belts, and jewelry.[1] The second involved an economic analysis of Leegin's marketing practices to determine whether or not they enable Leegin to have "vertical pricing control to monopolize the market," "penalize the consumers of goods," or otherwise somehow "reduces competition."

In conducting my research, I considered the economic literature on vertical arrangements. I also interviewed Leegin management and visited Leegin's headquarters and production facility in City of Industry, California; in addition I visited retail accounts selling Leegin merchandise as well as re-

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[1] Leegin divides its products into nine lines: belts, handbags, wallets, watches, jewelry, eyewear, luggage, gifts, and other. In the trade, Leegin's products are often called "fashion accessories."

tailers selling merchandise that competes with Leegin's products. I also visited the California Market Center and The New Mart in Los Angeles where hundreds of vendors of purses, belts, jewelry and women's clothing display and sell their wares at wholesale. In the course of my research, I read documents produced in this litigation as well as trade publications. I was given free rein by Leegin's attorneys to complete this report.

Cornerstone Research, an economic consulting firm in Menlo Park, California, assisted me in my analysis. No resources of the University of Virginia were used in its preparation. A list of the materials I considered in forming the opinions found in this report is attached as Exhibit 3. Because discovery has not ended, I reserve the right to modify or supplement my opinions based upon additional information or further analysis.

III. Organization of Report

My report is organized as follows. Section IV defines the central objective of antitrust law as the promotion of consumer welfare and explains that consumer welfare is at the heart of my analysis of Leegin's pricing strategy. In Section V, the economic analysis of resale price maintenance is laid out and I apply this analytical framework to the business model of Leegin. In Section VI, I describe the situations where economists raise objections about resale price maintenance and I show that these concerns do not fit the markets in which Leegin operates. Section VII of my report explains the absence of any antitrust injury associated with Leegin's conduct and also contains an evaluation of the expert report submitted by plaintiffs. The final section summarizes my conclusion that the Leegin business model, including its use of Suggested Retail Prices, is procompetitive and, in addition, favorable to small business.

IV. The Consumer: The Focal Point of Antitrust Economics

The purpose of antitrust economics is to sort out economic wheat from economic chaff: to distinguish procom-

petitive business conduct, which promotes consumer welfare, from anticompetitive behavior, which reduces consumer welfare.[2] Procompetitive conduct by sellers benefits consumers by lowering market prices and/or raising product quality.[3] Anticompetitive conduct harms consumers by raising prices (which reduces quantities sold) or reducing product quality. In economic analysis, product quality includes tangible attributes, such as durability and workmanship, and intangible attributes, such as style, cachet, and the overall shopping experience associated with buying the product.

The distinction between anticompetitive and procompetitive practices does not turn on the impact of the practice on competitors. Whether business conduct is procompetitive or anticompetitive depends on how it affects consumers, not rivals. For example, the plaintiffs in this litigation allege that because of Leegin's business model, they are harmed. But this contention does not address whether *consumers* are being harmed. The guarantor of consumer welfare is competition

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[2] The chairman of the Federal Trade Commission, testifying before the House Judiciary Committee, put the matter this way: "It is virtually undisputed today that the purpose of antitrust is to protect consumers, that economic analysis should guide decisions, and that horizontal cases involving mergers and agreements among competitors are the mainstays of antitrust." Timothy J. Muris, Prepared Statement of July 24, 2003, available at www.ftc.gov/os/2003/07/antitrustoversighttest.htm.

[3] Consumer welfare can be thought of as the difference between what a consumer pays for a product in the marketplace and the most that consumer would be willing to pay for that same product rather than going without it. One can see that, by this definition, a reduction in a product's price, *other things remaining unchanged*, adds to consumer welfare. Similarly, higher quality and easier availability, at the same product price, add to consumer welfare. To monetize the value of higher quality or easier availability, an economist calculates the price reduction on the unenhanced product that would be necessary to raise consumer welfare as much as getting the enhanced product at the original price.

among rivals in the marketplace, not preserving the *status quo* among rivals.

V. The Economics of Resale Price Maintenance

When they first learn that manufacturers sometimes endeavor to maintain a minimum resale price for their products, my students at the University of Virginia often are puzzled. Their intuition suggests that a manufacturer, having sold a product to a retailer, would then want the product to be sold at the lowest price possible so that consumers would buy more of the product rather than less. When a manufacturer endeavors to maintain a minimum price at retail, or discourage "discounting" by retailers, two questions regularly come to students' minds:

> Why would a manufacturer seek to "maintain" a higher retail price for its product?
>
> If a manufacturer succeeded in maintaining a higher retail price, what are the consequences for consumer welfare?

With regard to the first question, there are several reasons why a manufacturer might have a policy in place that influences downstream pricing. With regard to the second question, some applications of a resale price maintenance policy *can* enhance consumer welfare; others may have the opposite effect. This means any economic assessment of the issues in this case must connect the facts with the applicable economic principles as they apply to Leegin's pricing practices.

Let me begin with a note on terminology. From the perspective of antitrust economics, the focal point of this case is Leegin's Suggested Retail Price (SRP) policy.[4] At times I

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[4] See Exhibit 4 for a copy of Leegin's "Brighton Retail Pricing And Promotion Policy," which explains that Leegin "stands firm" regarding its Suggested Retail Prices. The plaintiffs also allege that Leegin charged excessive freight costs in transporting goods for some retail accounts.

[Footnote continued on next page]

shall refer to Leegin's SRP policy as one of resale price maintenance (RPM).[5] Both SRP and RPM describe a manufacturer of a branded product endeavoring to influence the downstream resale price of the manufacturer's product or product line. Normally this resale price is at the retail level (as it is in this litigation).

Manufacturers selling undifferentiated products in perfectly competitive and frictionless markets would never use RPM as a pricing practice. In such markets, transactions are made at an equilibrium market price for identical products and the manufacturer has no continuing interest in the disposition of its output once it has been paid the market price.[6] But in many commercial transactions involving branded products, economic analysis teaches that RPM can be an efficient pricing practice that benefits consumers. As some antitrust scholars would put it, RPM limits *intrabrand competition* but enhances *interbrand competition*.[7] To understand the economic logic that explains how RPM can do this, two economic concepts must be introduced: (1) consumer de-

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[Footnote continued from previous page]

See Complaint ¶¶ 21-23. Since these claims involve breach of contract and fraud, and not antitrust, I do not address them in my analysis.

[5] My use of the term "resale price maintenance" is in its economic context. The existence of RPM, to an economist, does not by itself mean (or even suggest) that there is an "agreement" between a manufacturer who implements a resale price policy (such as Leegin's) and a retailer who charges those prices. The economic analysis of RPM does not pivot on the existence of a legal "agreement" between the upstream manufacturer and the downstream distributor.

[6] It is in this world where my students' instincts are correct: a manufacturer selling in such a market would want the lowest retail price possible since this would increase market volume.

[7] Intrabrand competition is a synonym for within-brand competition. Interbrand competition is a synonym for between-brand competition.

mand for a product depends on more than the product's price; (2) the free rider.

V. A. RPM as Demand-Shifter

In the world of differentiated consumer products, such as those at issue here, demand is a function of price, quality, design, and retail service.[8] When demand is a function of retail service, this means improvements in retail service raise consumer demand. Mathewson and Winter describe some of the sources of increased demand:

> Additional demand factors include: the number of outlets or availability of the product, the convenience of the outlet's location, the information provided to customers at the point of sale, the sales effort and talent of dealers, the reputation of the product for quality, the prominence of the display of the product and so on. . . . Protecting a higher retail margin increases the marginal benefit that each retailer gains from attracting an additional customer by providing service, and therefore increases the amount of service that each retailer will provide. The general "service hypothesis" is that the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher[]retail price."[9]

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[8] Retail service is defined broadly to include such variables as pre-sale display, product-specific information about a product, store hours, post-sale service, the reputation of the retailer as a certifier of product quality, and the overall shopping experience.

[9] Frank Mathewson and Ralph Winter, "The Law and Economics of Resale Price Maintenance," *Review of Industrial Organization*, Vol. 13, April 1998, p. 67, internal footnote omitted.

Economic theory shows that an increase in demand caused by increased retail service can make consumers better off, even if accompanied by a price increase.

To apply this to the *Leegin* litigation, economic analysis raises the prospect that the SRP policy of a firm like Leegin might influence retailer behavior so much (in promoting the Brighton product line) that the increase in consumer demand results in more product being sold despite a higher price. As a consequence, consumer welfare is increased. Put differently, economists recognize that retail service, retail amenities, retail location, retail inventories, and retail information can all be components of consumer welfare. The economics of RPM teaches that it is incorrect to think that only low prices determine consumer welfare.

V. B. RPM and the Free Rider

It is instructive to ask why, absent a manufacturer's SRP policy, retailers would not have economic incentives to provide pre-sale and post-sale services "on their own" in any market in which consumers valued them? The answer economic analysis provides is the free rider. In economic lingo, the free rider is a form of "market failure." Manufacturers with SRP policies are trying to remedy this market failure. To understand Leegin's pricing policy from an economic perspective, it is necessary to understand the economics of the free rider.

A free rider is someone who enjoys the fruits of someone else's (costly) economic endeavors. The iconic free riding example is the high-tech, information-intensive consumer durable (think of high-end audio equipment) that requires considerable pre-sale information by a knowledgeable salesperson at a retail establishment to inform and persuade a consumer of the product's merits. Upon getting the requisite information at the full-service retailer, the shopper leaves the store without making a purchase, travels to a discount operation that stocks the product the consumer now knows she wants, and buys it for a lower price. The lower price is pos-

sible because the buyer and ultimate seller can free ride off the costs born by the full-service retailer.

In markets where free riding is common, sellers may reduce their participation because they are not provided adequate remuneration. Consumers may reduce their participation in such markets because they are not provided adequate pre- or post-sale services. The upshot is a reduction of output in such markets. In the extreme, the entire market for a desirable good (one where value exceeds opportunity cost) can go away because of free-riding. Consequently, free riding is not a sustainable (economists would say "equilibrium") market situation; it does not maximize consumer welfare. SRP policies that protect retail margins and thereby thwart the discounter are one way to eliminate the free rider problem. This is the solution that Leegin (and many other businesses) have adopted in various forms.

The free rider problem is not confined only to high-tech, information-intensive consumer durables.[10] RPM occurs in markets where goods do not require detailed information, extensive product demonstration, or significant post-sale service commitments. A Leegin bracelet or wallet would be an example. Other such products might include shirts, shoes, candy, and designer jeans. In the case of such products, retailers may use protected margins to invest in greater services (e.g., longer hours of operation, nicer store furnishings, additional sales force training) that signal or certify the quality of their merchandise.[11] This may increase the demand for the manufacturer's product, giving manufacturers of products

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[10] This is the form of free riding discussed in Lester Telser's pathbreaking article on protected retail margins. See "Why Should Manufacturers Want Fair Trade," Journal of Law & Economics Vol. 3, October, 1960, pp. 86-105, especially p. 91.

[11] The standard source is Howard Marvel and Stephen McCafferty, "Resale Price Maintenance and Quality Certification," *Rand Journal of Economics*, Vol. 15, Autumn, 1984, pp. 346-359.

that merit this treatment an incentive to have an SRP or RPM policy.[12] Once these investments in quality certification have been made, they are subject to free riding without an effective SRP or RPM policy. Free riding occurs when stores offer these products at a lower price, and can do so because they are free of the responsibility and expense of endorsing the products' quality.

Improving retail promotion of its Brighton product line and thwarting free riding is what Leegin endeavors to accomplish by its SRP pricing practice. The couple who founded Leegin began their business as a small independent retailer and this led the firm, as a manufacturer, to focus on independent retailers as a way of creating a distinctive brand of fashion accessories.[13] Leegin wanted a high-service shopping experience to be part of the Brighton brand and believed that independent retailers could provide those services.[14] The incentive a retailer has to develop and promote the Brighton brand comes in part through its quality and design signature; it also comes through Leegin's SRP policy, which means that the store would not engage in free riding.

In this lawsuit, Kay's and Toni's are classic free riders. They are not firms whose business model benefits consumer

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[12] Obviously, a product whose quality is low cannot survive in the marketplace if the product has been priced at a high retail margin. An RPM policy does not enable a manufacturer to make a silk purse out of a sow's ear.

[13] The one exception that proves this rule is Nordstrom's. Leegin had served this department store chain before its business model was refined and has continued its relationship with this retailer.

[14] My understanding is that many retailers today attest that the Brighton line gave them an entry point in competing against larger, established chain stores in the sale of belts, handbags, jewelry and other such products. In my visits to stores that sell Brighton products, I was struck by the attentive customer service and the retailers' enthusiasm for the Brighton line.

welfare. Quite the contrary, their failure to abide by Leegin's SRP policy will disincent other retailers from promoting the Brighton line. Over time, as the Brighton line becomes less valuable to consumers, it will become less valuable to retailers, including Kay's and Toni's as well. In the meantime, Kay's and Toni's would reap the fruits of free riding. If Leegin is forced off its business model, it will be a less viable competitor in women's fashion accessories.

Indeed, Mr. Phillip Smith, the owner (with his wife) of Kay's, noted in his deposition that "[h]e increased . . . purchases from [Brighton] by better than fifty percent" in the first six months after Kay's began heavily discounting Brighton products. (Oral Statement of Phillip Craig Smith, Sr., KK021608, 2/12/2003) Mr. Smith considers this to be evidence of the anticompetitive harm of Leegin's SRP policy. He has it exactly backwards. Kay's conduct squares with that of a free rider. Its sales jump, as a free rider's would, because other retailers are providing (in the short term) the marketing services that undergird and expand the market demand for Brighton products. If Kay's free-riding caused an erosion of margins for other retailers in the area, this would lead to a reduction in demand for Brighton products (since demand is in part a function of retail amenities).

What plaintiffs do not seem to understand is that Leegin's business model is not designed to enable retailers to gouge consumers nor is it designed to enable retailers to make monopoly profits off the Brighton brand. Leegin has no incentive to overcompensate its retailers. Doing so would reduce the profits Leegin might make *and* it would make Leegin merchandise less competitive in the marketplace. Leegin wants its retailers to "make as little money as possible" and still be willing and able to market the Brighton line attractively and effectively. Leegin's SRP policy permits Leegin to compensate its retailers for the level of service it wants Brighton customers to enjoy at the retail level; Leegin's objective in all this is to enhance *interbrand competition*.

To the extent that Leegin is mistaken about what consumers want, interbrand competition will discipline Leegin because the firm's SRP policy in no way insulates Leegin from the competition of other manufacturers who use different marketing strategies and distribution channels to vie for consumer patronage. Vigorous interbrand competition, and Leegin's incentive to be successful in this arena, determines the ultimate retail prices of Brighton merchandise.

It is one thing to acknowledge the economics of RPM and endeavor to explain that it does not apply to the facts of a particular situation. But here the plaintiffs' Complaint not only fails to consider the economic analysis of RPM, it reflects no awareness of this analysis. Nor does the December 5, 2003 report of plaintiffs' forensic accountant, Dr. James D. Woods. The absence of any economic analysis on the plaintiffs' side of this case is itself revealing. One is reminded of the Arthur Conan Doyle novel *Silver Blaze* where Sherlock Holmes made much of the dog that did not bark.

VI. Potential Negative Economic Consequences of RPM

Having set forth the standard economic analysis of RPM, and shown how Leegin's SRP policy benefits consumers, it is instructive at this juncture to consider the conditions where RPM does *not* shift consumer demand in a welfare-enhancing fashion and as a consequence has the potential to reduce consumer welfare. Economic analysis suggests three ways in which RPM can contravene antitrust's fundamental goal of promoting consumer welfare. Of the three public policy arguments against RPM, two involve the prospect of *cartel formation* in a market characterized by RPM. In the first instance, the cartel is formed at the level of downstream distributors (such as retailers); in the second, the cartel is formed at the level of the manufacturers -- but the cartel

makes use of RPM to strengthen the cartel.[15] Let me take these situations up and then turn to the third public policy argument against RPM.

VI. A. RPM-Induced Retailer Cartels

In the case of a cartel at the retail level, retailers behave collusively to get manufacturers to adopt policies that set resale prices at the cartel-optimum level for the retailers. Because manufacturers appear to be setting retail prices vertically, this diverts attention from the horizontal exercise of collective price-setting by the retailers. Furthermore, by inducing manufacturers to "impose" an RPM policy upon them, retailers in effect deter themselves from cheating on the agreement and competing on price themselves. In this scenario, retailers use manufacturers' RPM policy as a cover for their own cartel endeavors. Retailers thereby delegate part of the enforcement of the cartel to the manufacturer.

For RPM of this variety to work, retailers must possess what economic theory calls "monopsony power" and the manufacturer must go along with the practice even though its sales are reduced. Retailers must have the clout to cajole manufacturers to maintain retail prices, so the retailers need not enter into a direct price fix.[16]

How do consumers fare when RPM is used as the cat's paw for a retail cartel? They are made worse off, the same as

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[15] For a manufacturer, "downstream" could mean any point in the distribution chain from the manufacturer's shipping dock. For purposes of exposition, I refer to the downstream level as the retailer. It would not affect the analysis if I were to use wholesalers or other participants anywhere in the distribution channel from manufacturer to ultimate consumer.

[16] The simple model of an RPM-induced retail cartel does not explain or account for how retailers could avoid their cartel being undermined by other forms of competition, such as non-price rivalry or retailers undercutting the manufacturer's price minimum by offering free or discounted products contingent upon the purchase of the RPM good.

they would be if the cartel were operated directly by retailers without the participation of upstream manufacturers. The textbook example here is a cartel of retail druggists who, working through a trade association, cajoled the manufacturer of Pepsodent toothpaste to implement RPM. But there is no evidence that retailer-induced cartels are common.

There also is no prospect that a horizontal agreement among the hundreds of independent gift stores, women's apparel stores, and specialty shops that sell Brighton handbags, jewelry, belts and other items in the Brighton line could be effective. There are at least three reasons this is the case.

First, there are many small, geographically dispersed retailers that sell the Brighton line.[17] Leegin lists 2,879 retailers in 49 states and the District of Columbia that carry Brighton products. In Texas alone, Leegin serves 380 retailers, 137 of which are the only store carrying Brighton products in the town. In addition, there are many more retailers of women's fashion accessories that do not carry the Brighton line but carry competitive products. For example, according to the 1997 Economic Census, in Texas alone there were a total of 3,164 women's clothing stores, clothing accessories stores, and luggage and leather goods stores.[18]

Anyone who has been a student of cartels would realize how implausible it would be for all retailers of the Brighton product line to surmount the logistical complications of communicating with one another, deciding collectively what prices would be charged on the hundreds of items in the Brighton line, and then enlisting the Leegin management in the scheme so that Leegin's SRP policy could serve as "the front" for the retailer cartel. Moreover, the kind of retailers

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17 See www.brighton.com/retailers/index.html.

18 See U.S. Census Bureau: Texas Retail Trade, Summary Statistics for the State: 1997, Table 1, 12/9/1999 at www.census.gov/epcd/ec97/tx/TX000_44.HTM.

carrying the Brighton line would be especially unlikely to form a cartel because Leegin's channel focus is on small, independent retailers, not the nation's large chain retailers. To make the cartel effective, other retailers of fashion accessories that compete with Brighton products would have to be brought on board, further compounding the communication and coordination obstacles.

Second, in my own study of the record in this case, I encountered not even a hint that there is a retail cartel in place. In my field trips and review of trade literature, I find no suggestion that retailers are in cahoots in setting the retail prices on Brighton merchandise.

Third, as I understand the Complaint, the plaintiffs have not alleged a retailer cartel. I take that to mean that in their own experience, they have neither encountered nor gathered any evidence of a retailer cartel. Dr. Woods, in his report, also makes no mention of a retail cartel hypothesis.

VI. B. Manufacturer Cartels Using RPM

In a typical cartel, sellers collude on the price they charge their customers and do not endeavor to set the resale price of their product.[19] Nonetheless, a cartel of manufacturers might use RPM to help monitor and enforce the cartel's collusive behavior. In this economic model, manufacturers collude on the prices they charge their retailers. To make the cartel more effective, i.e. to reduce the incentives to cheat on the cartel price, each manufacturer in the cartel also has an RPM policy in place with retailers (at a price the manufacturers jointly determined).

In a traditional cartel, there is a strong incentive to cheat on the agreement by shading price and expanding output.

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[19] For example, I worked for plaintiffs on the recent international cartel in the vitamins industry. While participants in the vitamins cartel agreed upon the prices they charged, they did not try to influence prices *their customers* charged.

Incremental sales typically are very remunerative because the cartel has jacked up the price. But where a cartel of manufacturers has made RPM a part of the cartel arrangement, a manufacturer who cheats gains no additional sales. The cheating firm simply enriches its retailers (unless its retailers also lowered their prices, which might be observed by other cartel members as a violation of the manufacturer's RPM policy).

In other words, manufacturers agree to set a collusive price to *their* customers and, in addition, agree to maintain a common collusive price that downstream retail vendors are to charge *their* customers. If price cuts did take place at retail in response to a cartel cheater, this would alert the manufacturers that they have a cheater in their midst: the manufacturer who serves, or primarily serves, that particular retailer.[20]

Just as real world examples of retailer cartels that use RPM as a mechanism for collusion are not common, real world examples of manufacturer cartels that used RPM as a monitoring and enforcement device also are uncommon. Pauline Ippolito's study of RPM litigation finds less than 10% of private cases involve even the *allegation* of manufacturer or retailer collusion.[21]

There is no evidence of a horizontal agreement between Leegin and the hundreds of manufacturers that make handbags, jewelry, belts and other items that compete with the Brighton line. The impediments to a manufacturer cartel are substantial. One problem is the sheer number of manufactur-

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20 This type of cartel works best when the product is homogeneous. Any non-price competition among the putative cartel members would be difficult to detect if the products are differentiated.

21 Pauline M. Ippolito, "Resale Price Maintenance: Empirical Evidence from Litigation," *Journal of Law & Economics*, Vol. 34, October 1991, pp 263-294.

ers. Forming and policing a cartel in any market becomes more difficult as the number of firms increases. Data on the manufacturing base for this industry are not easy to come by. But Census data indicate that there were 137 women's handbag and purse manufacturing establishments alone (operated by 136 companies) in the United States in 1997.[22] The available data make clear that a manufacturer cartel in women's handbags and purses is implausible if not impossible.

A second obstacle to the formation of a manufacturer cartel is the ease of entry and high supply elasticity in the market. There are no key inputs that Leegin controls that would keep out new entrants if, hypothetically, a cartel were operative. In addition, if the cartel did not embrace all manufacturers, there would be a high supply elasticity among vendors who can manufacture competitive products. Some could even be suppliers of the hypothetical cartel, who would produce output for non-members as well. In addition to the sheer number of actual producers of women's fashion accessories, there are other manufacturers who could, with modest switching costs, begin producing these items if prices were to be set at supra-competitive levels. Thus, any cartel involving Leegin and other manufacturers that attempted to get underway would face competition from new entrants and existing firms.

My plant tour of Leegin's production facility illustrates this point. The production process is not capital-intensive and no large investments would be required to reproduce the facility. This is not an industry with high entry barriers. Indeed, the building Leegin occupies does not have assets that are specific for manufacturing only the Brighton line. It also could support the production of competitive products. This suggests that if other entrepreneurs wanted to enter the market and compete with Leegin (and its incumbent rivals), there

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22 U. S. Census Bureau: "Women's Handbag and Purse Manufacturing," Tables 3 and 4, 12/11/1999, pp. 8-9.

is no bottleneck on inputs that are controlled by Leegin and unavailable elsewhere. Likewise, if Leegin's current rivals wanted to expand their supply, there are no resource constraints that would prevent them from doing so.[23] Consequently, a cartel of manufacturers is unimaginable, not only because of the large number of firms, but because these firms do not market their output in the same way.

Third, there is no mention in the plaintiffs' Complaint of a manufacturer cartel (in which Leegin is a putative participant). Dr. Woods, in his report, also makes no mention of a manufacturer cartel hypothesis. Here again, the dog that does not bark comes to mind.

VI. C. RPM and the Marginal and Inframarginal Consumer

The main economic objection to RPM is when it is used as a device to enable or facilitate cartelization of markets.[24] A third concern economists have raised about RPM is whether it helps some consumers, harms others, and on net does more harm than good. I am unaware of this particular RPM theory having any influence in antitrust law.[25] The theory assumes two kinds of consumers who value a particular product: one (the so-called "marginal" consumer) is ill-

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23 While the skills and tenacity of Leegin employees I observed assembling some of the Brighton products are remarkable, nonetheless the skills could be taught to employees of other firms who either want to expand sales in this market or become a new entrant.

24 My understanding is that the use of RPM to organize and operate either a retail or a manufacturer cartel is unlawful under the antitrust laws.

25 The theory can be found in William B. Comanor, "Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy," *Harvard Law Review*, Vol. 98, March 1985, pp. 983-1002. See also Don Boudreaux and Robert B. Ekelund, Jr., "Inframarginal Consumers and the Per Se Legality of Vertical Restraints," *Hofstra Law Review*, Vol. 17, Fall 1988, pp. 137-158.

informed about a product but might purchase the product if its sale were accompanied by retail promotion and services that make him or her a knowledgeable consumer. To the extent a manufacturer's RPM policy induced and incented these services, "marginal" consumers become better off (i.e., enjoy more consumer surplus). The "inframarginal consumer" is satisfied with the product in "plain vanilla" form, or already is so informed about the product's characteristics that additional retail sales and service endeavors are unnecessary or of little value. The inframarginal consumer is happy to buy off-the-shelf at low prices.

Economic analysis can show that in the case of a market with lots of inframarginal consumers, and few marginal consumers, RPM can reduce overall economic welfare. On the other hand, economic analysis can show that in a market with few inframarginal consumers and many marginal consumers, RPM can increase overall economic welfare. To weigh the impact of RPM upon consumers becomes, under this theory, a matter of counting noses.

In the context of the antitrust case against Leegin, this theory does not fit the facts. Leegin's pricing policy is designed to induce and incent store-owners and sales personnel to promote the Brighton line, and to enable Leegin to compete with larger department stores offering more prominent brands. Leegin's pricing policy does not prevent other manufacturers from selling belts, handbags, and purses in "plain vanilla" fashion or at price points higher than Leegin's products. Consumers who want low-price and less fashionable merchandise have many brands and retail locations to choose from. For example, "everyday" low price purses can be purchased at Sears, K-Mart, Target, and Wal-Mart, as well as thousands of independent retailers and discount stores.

At the same time, those consumers who want women's accessories retailing at price points at or above the Brighton line are not deprived of these options because of Leegin's SRP policy. The brands of Louis Vuitton, Gucci, Prada and Francesco Biasia would come to mind for the fashion con-

scious. Consumers who want name brand fashion accessories sold seasonally at relatively high prices, then offered "on sale" at discount prices, have this option at department store chains and other retail outlets that "pulse" their prices.

The inframarginal-marginal consumer theory has other shortcomings when applied to this case. I have seen no evidence, from plaintiffs or from my own research, that consumers of women's fashion accessories fall neatly into two discrete bins: marginal and inframarginal. Some consumers may be well-informed with regard to belts but not with regard to eyewear. Moreover, some inframarginal consumers of, say, handbags, may have become that way earlier through knowledge gained at retail stores that provided them with pre-sale product information and post-sale services.

Presumably a manufacturer would only implement RPM if it pays off because more consumers are in the marginal category. The fact that Brighton's output has grown considerably while the SRP policy has been in place indicates strongly that consumers on net have benefitted.[26] One antitrust authority, who is now a federal appellate judge, considers this to be *the key indicator*. Richard Posner explains:

> "If [the defendant firm's] output expanded, the restriction must have made the firm's product more attractive on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition. The increase *must* exceed any net reduction in intrabrand competition considered in both its price and service aspects. Any reduction in

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26 For example, Brighton handbag sales grew from 125,609 units in 1996 to 375,480 in 2003. Brighton jewelry sales (includes home products) grew from 0 units in 1996 to 3.56 million units in 2003.

> intrabrand competition, viewed by itself, would increase the price to the consumer and hence make the product less attractive to him. If, on balance, the product is more attractive to consumers, as demonstrated by the fact that more of it is sold, the net effect of the restriction on competition must be positive."[27]

The plaintiffs do not raise the marginal vs. inframarginal theory in their Complaint against Leegin. Nor does Dr. Woods, in his report submitted on behalf of the plaintiffs. It is just as well. The theory does not apply to this case.

VII. RPM and Antitrust Injury: Rule of Reason versus *Per Se* Analysis

My understanding is that antitrust law applies to situations where there has been antitrust injury, meaning that a distortion in the competitive process has harmed consumers or, in economic terms, reduced consumer welfare. For some business practices, the harm to consumers is so transparent that courts consider the conduct to be *per se* illegal. Economic logic suggests that the *per se* category of antitrust offense should be for business conduct so unlikely to ever confer consumer benefits that a full-blown (or "rule of reason") inquiry into the practice is not worth the candle.

VII. A. Squaring Price and Non-Price Vertical Arrangements

As I teach my students, at one time a number of vertical practices were thought to be so unlikely to generate consumer benefits that they were considered *per se* violations of antitrust law. Exclusive territory and RPM agreements are examples. As courts discovered the pro-competitive benefits of exclusive territories, this marketing practice was moved to

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[27] Richard A. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," *University of Chicago Law Review* Vol. 48, Winter 1981, p. 21, emphasis in original.

the rule of reason bin. The decision by the Supreme Court that accomplished this move, *GTE-Sylvania*,[28] explicitly cited the economic concept of the free rider.

To the extent prevailing antitrust law governing non-price vertical arrangements is properly calibrated, this would suggest the rule plaintiffs propose regarding vertical arrangements on price is asymmetric with the economic logic of *GTE Sylvania, Inc.* In other words, if the *per se* rule is to thwart conduct that is always (or almost always) anticompetitive, then to apply the *per se* rule to all situations of RPM is to misapply the rule. Economic analysis reveals those circumstances when RPM can cause antitrust injury. But economic analysis also reveals the circumstances when price and non-price vertical practices can be procompetitive. Both price and non-price vertical practices have the potential to increase interbrand competition.[29]

To square the economics of RPM with that of other vertical arrangements, and maintain the obvious enforcement benefits of a *per se* rule, RPM would be *per se* illegal when it is associated with a horizontal combination. In the absence of any horizontal component, vertical arrangements on price would be viewed under the rule of reason.[30]

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[28] *Continental T.V., Inc. et al. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

[29] The enhancement of interbrand competition is not undermined by effects on price. Non-price vertical arrangements, such as exclusive territory agreements, have a price effect.

[30] A rule of reason inquiry need not be an expensive and time-consuming task for the court if the manufacturer using RPM does not possess market power of antitrust concern (i.e., where there is abundant interbrand competition). Any firm that does not have a large market share, is not protected by high barriers to entry, or faces a high supply elasticity from other rivals, does not have significant market power. Such a firm, not in cahoots with its rivals, cannot use RPM to cause antitrust injury. As explained earlier, interbrand competition would discipline

[Footnote continued on next page]

Leegin's SRP pricing practice is at the opposite end of the spectrum from what a *per se* rule is intended to cure. Leegin's strategy to protect retail margins in order to incent retail services merits a rule of reason inquiry. In fact, I know of no economist who presently endorses a *per se* approach to either vertical price or non-price marketing practices that are unilateral and implemented by firms without market power of any antitrust concern. The business model of Leegin, with regard to SRP, clearly does not fit in antitrust's *per se* bin.

VII. B. RPM and the Meaning of "Agreement"

The decision by the Supreme Court recognizing a manufacturer's right to implement RPM unilaterally is *Colgate*.[31] The *Colgate* doctrine, as I understand it, affords a manufacturer the option to announce a take-it-or-leave-it policy of selling only to downstream vendors who price at the manufacturer's SRP. *Colgate* allows a manufacturer to enforce its RPM policy by refusing to do business with retailers who shade or cut the SRP.

The plaintiffs contend, as I understand their Complaint, that because many retailers adhere to Leegin's SRP, this shows there must be an "agreement" between Leegin and these stores.[32] Dr. Woods, in his report, echoes this line of reasoning, concluding that if there were no agreement, all retailers would behave like Kay's and cut prices.[33] Both the plaintiffs and Dr. Woods are mistaken in their analysis.

[Footnote continued from previous page]

such a firm if its RPM strategy did not enhance consumer welfare. Indeed, a firm without market power that uses RPM does so in the hope that it will make the firm a more vigorous interbrand competitor.

31 *U.S. v. Colgate & Company*, 250 U.S. 300 (1919).

32 Complaint ¶¶ 17-18.

33 Woods Report, p. 5.

The fact that a group of firms behaves the same way does not mean they have collectively decided (or "agreed among themselves") to behave that way. This is not only true as a matter of economic theory,[34] it is a basic principle of antitrust analysis.[35] In like fashion, the fact that a group of retailers willingly abide by Leegin's SRP policy does not imply any cartel agreement on their part nor agreements between them and Leegin. Each retailer, facing Leegin's take-it-or-leave it pricing policy, has the option of electing to follow Leegin's business model, or not distribute Brighton products. A retailer who chooses to adopt the SRP policy recognizes that adhering to Leegin's SRP generates benefits for the retailer because it can provide the marketing services Leegin wants Brighton's customers to enjoy. In the process, the retailer can still make a competitive rate-of-return.

Thousands of retailers have decided *not* to stock the Brighton line and therefore have decided not to abide by Leegin's SRP policy. Based simply on actions and behavior, these retailers have no more "agreed" among themselves not to engage in RPM with Leegin than the hundreds of retailers who independently elect to follow Leegin's SRP policy have "agreed" to participate in Leegin's SRP program. If a particular retailer elects not to distribute Brighton products, presumably that is the optimal course of conduct for that firm. If another retailer elects to distribute Brighton products under

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34 In the economist's model of perfect competition, sellers all charge the same price. But in the theory of perfect competition, there is no cooperative behavior among the many sellers. In oligopoly markets, the fact that one firm follows the price lead of another does not mean that the two firms have "agreed" on a price. Indeed, absent agreement, a first mover on price cannot prevent a second or third mover from unilaterally following its lead. Parallel behavior, in other words, is not necessarily collective behavior.

35 See Philip E. Areeda and Herbert Hovenkamp, *Antitrust Law*, 2nd edition, 2003, Vol. VI, pp. 59-66 and following.

the SRP, presumably that is the optimal course of conduct for that firm. In either case, the choice remains with the retailer and, in the context of this market, the consumer is not harmed by the unilateral choices of these retailers, whichever is their choice. In short, based on economic analysis, there is nothing about the conduct of Leegin or its retailers that excludes the possibility of unilateral behavior.

The particular phraseology involved in the documents that set forth Leegin's SRP policy impact neither the retailers' incentives nor Leegin's.[36] The key elements required for the policy to have its procompetitive effects are that it be enforced (i.e., discounters are no longer supplied by Leegin) and that prospective retailers of Brighton products are aware that Leegin's SRP policy will be enforced. In this environment, retailers' choices are independently made in response to these terms and the *Colgate* standard is met.

Leegin has independent (or unilateral) incentives to operate in accord with the *Colgate* doctrine and economic analysis offers an explanation why this business model makes sense for this firm. Leegin is a small player in a competitive industry marked by high supply elasticity and low entry barriers. Leegin sells a product that it seeks to differentiate from its rivals and faced with a classic free rider problem it makes use of the *Colgate* doctrine to implement and enforce its SRP policy. If there is any prospect of consumer

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[36] Leegin's SRP policy was implemented in April 1997 when letters describing the policy were sent to retailers. The Brighton Heart Store program began later, *circa* January 1998, and the description of this program reiterated the existing SRP policy. Nothing about the original statement of the SRP policy or its restatement in the literature describing the Heart Store program indicate any difference in what Leegin hoped to accomplish: to deter free riding and incent retailers to promote the Brighton product line. (See "Declaration of Jerry Kohl in Support of Leegin's Opposition to Plaintiffs' Motion for Partial Summary Judgment," 11/25/2003, ¶¶ 15, 23, and 25.)

harm or antitrust injury from Leegin's use of RPM, I have been unable to uncover it. Nor are there marketing options available to Leegin that are more commendable from the standpoint of antitrust economics.

VII. C. Leegin's Options

One option available to Leegin is simply to state the SRP policy and then make no effort to enforce it. Clearly, this is equivalent to having no SRP policy at all and neither Leegin nor consumers of Brighton products would receive any of the benefits from RPM that I have described. In the event of a deviation from the SRP policy (i.e., discounting by a retailer), Leegin must protect the integrity of its pricing strategy by terminating its relationship with the offender.[37] If Leegin continued to supply discounting free-riders, adherence to the SRP policy could erode and ultimately Leegin's business model would be undermined. Since Leegin's pricing policy results in the efficient distribution of its product line, and enhances rather than restricts demand, laxness on the part of Leegin would result in harm to consumers.

As a second option, Leegin might have used vertical arrangements other than its SRP policy to induce downstream marketing service and avoid the free-rider problem. However, in the market for women's fashion accessories, non-price vertical arrangements have shortcomings (for Leegin and for consumers) that an SRP practice does not have. For example, exclusive territories can make economic sense if the items sold are big-ticket items and if consumers have

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37 According to Mr. Jerry Kohl, Leegin rarely needs to exercise this option. (See "Declaration of Jerry Kohl in Support of Leegin's Opposition to Plaintiffs' Motion for Partial Summary Judgment," 11/25/2003, ¶ 22.) The fact that Leegin seldom must cut off retailers for violating the SRP policy is not proof of an agreement between Leegin and its retailers. Rather, it is evidence that the policy is effective: each participating retailer understands it is in that firm's interest to follow Leegin's SRP policy.

high transaction costs of visiting alternative retailers. In women's apparel, however, many items are not high price and retailers do not try to "cultivate" a particular geographic territory that becomes its exclusive customer base. Most consumers of fashion accessories are too mobile for such a marketing strategy to be effective because shoppers often have a number of retail outlets nearby. In fact, Leegin and consumers both can benefit from having a denser distribution of Brighton products than exclusive territories would allow.

As a third option, Leegin could become fully vertically integrated: from manufacturer to retailing. This would eliminate SRP as a pricing policy. However, this business model would draw Leegin away from its core competency (creating and manufacturing women's fashion accessories); it would require Leegin to have additional financial capital; and it would likely result in a less dense distribution of Brighton products than the SRP practice currently generates. Moreover, the numerous small, independent retailers that now carry the Brighton line might be eliminated (or shrink in number).

It would be an odd application of the antitrust laws if Leegin were required to eschew independent centers of initiative in the marketplace and become fully integrated vertically in order to comply with the plaintiffs' view of the Sherman Act. Indeed, having a set of thriving, independent retailers that carry Brighton *and non-Brighton* products is an indicator of the competitive diversity in women's fashions.

Based on my study of the Leegin business model, and the firm's use of SRP with regard to its Brighton line, I am persuaded that the business practices the plaintiffs complain about are pro-consumer and enhance competition for the consumer's dollar. Leegin's business model does not enable Leegin to have, as the Complaint in this case alleges, "vertical pricing control to monopolize the market."

VII. D. The Plaintiffs' Expert Report

As mentioned earlier, on December 5, 2003 plaintiffs filed a report by Dr. James D. Woods, the head of the foren-

sic accounting and investigative practices unit at the consulting firm of Grant Thornton. Normally my report would contain a detailed analysis of the plaintiffs' expert report. But Dr. Woods' report contains no economic analysis of the markets involved in this litigation, either at the manufacturing or the retailing level. That is, one does not find in his report any study of the market's structure or conduct. Based on the data in Dr. Woods' report, one would not know if Brighton was the only brand of handbags available to consumers in the market, or whether Brighton was one of thousands of handbag brands, or whether it made a difference to his analysis one way or the other.

In addition, Dr. Woods' report contains no explicit discussion of the economic theory of RPM. For example, Dr. Woods never mentions the free rider -- even though the free rider normally would be a part of any economist's analysis of RPM. Evaluating Leegin's business model without any discussion of the economic concept of the free-rider is like evaluating the career of Thomas Edison but not mentioning the light bulb or studying the career of George Eastman but overlooking the camera.

Moreover, Dr. Woods never connects his report to the plaintiffs' Complaint. The Complaint alleges that Leegin has engaged in "vertical pricing control to monopolize the market." It is standard procedure in antitrust cases, where monopolization is charged, to define the relevant market(s) in which the alleged monopolization is purported to take place. The Complaint asserts "anticompetitive effect in the market for the Brighton line." (Complaint ¶ 17) But surely the Brighton product line is not a relevant market for antitrust purposes. If it were, then each and every firm that sells a branded product has a monopoly over the "market" for its "line." The "market for the Brighton line" is not a relevant market by any standards of market delineation of which I am aware.

Dr. Woods does not remedy the Complaint's deficiency of not defining a relevant market. Nowhere does he define a

relevant market, explain what market he analyzed, or purport to show that any relevant market has been monopolized or faces even a remote prospect of being monopolized. Of course, this omission in Dr. Woods' report is understandable. There are no data to support the Complaint's allegation of a "market for the Brighton line" and no evidence showing Leegin to have monopolized *any market, anywhere, any time.*

For example, consider just handbags. In my visit to The New Mart and the California Market Center, I observed dozens of vendors of women's handbags alone who use these locations to market their merchandise to retailers.[38] The New Mart directory lists 46 vendors of handbags, from Anja Flint to Viva Bags. The California Market Center has 112 vendors of handbags, from Alok Goel to Yancha. The day I toured the Center, the lobby alone had eleven companies displaying their lines of women's handbags. Many of the vendors offer dozens of models and styles of handbags. To claim, as Plaintiffs do, that Leegin's SRP policy "penalize[s] . . . consumers" and gives Leegin "vertical pricing control to monopolize the market" would sound bizarre to anyone who saw the enormous array of women's accessories being marketed just at these two locations.

If that were not enough, if one walks from The New Mart or California Market Center buildings a couple blocks (to the intersection of Santee Street and Olympic Boulevard and the environs), one enters a neighborhood of dozens of firms that sell clothing and women's accessories, at both retail and wholesale. Handbags, belts, jewelry, and luggage to stock a retail outlet are in abundant supply. And if that were not enough, I am told that much the same phenomenon exists in Dallas, Atlanta, and in New York. All this shows that if

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[38] Essentially, these are wholesale markets that bring together manufacturers and retailers. Consumers of clothing and accessories generally are not eligible to shop these premises. The exception, as I understand it, is on days when samples are being sold.

Kay's cannot handle the Brighton brand, there is no shortage of substitutes and alternatives available in the marketplace. One would, however, have no knowledge of this based on a reading of Dr. Woods' report or from the plaintiffs' Complaint.

Dr. Woods singles out the inventory requirements applicable to Brighton Heart Stores in his report. (See Woods Report, pp. 3-4) But there is no antitrust injury associated with Leegin's inventory policies. Economic analysis recognizes that RPM can help both manufacturers and retailers optimize inventory holdings in a fashion that ultimately benefits consumers.[39] By maintaining a minimum resale price, retailers are protected from the prospect of losses from price wars. In response, retailers maintain adequate in-store quantities of the product to satisfy consumers during times of high demand. In situations when demand for the Brighton line is high, consumers avoid the disappointment of understocked stores and can purchase the product when they wish.[40] As with the other effects of Leegin's business practices, the use

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[39] The standard academic reference is Raymond Deneckere, Howard P. Marvel, and James Peck, "Demand Uncertainty, Inventories, and Resale Price Maintenance," *Quarterly Journal of Economics*, Vol. 111, August 1996, pp. 885-913. Dr. Woods notes that Leegin would permit retailers to reduce the price of poorly performing Brighton products and laments that Leegin forbad advertising of such markdowns. In fact, this "escape hatch" allows retailers to recoup some of their losses when demand is low yet preserve the value of the Brighton brand to consumers.

[40] Consistent with the policy, however, retailers were permitted to place discontinued or poorly selling Brighton products on sale to make room for new products in the Brighton line. This practice is part of Leegin's strategy of ". . . assist[ing] retailers in determining which products were selling and making decisions about inventory." See "Declaration of Jerry Kohl in Support of Leegin's Opposition to Plaintiffs' Motion for Partial Summary Judgment," 11/25/2003, ¶ 5.

of RPM to facilitate sufficient inventory holdings benefits consumers.[41]

Dr. Woods also belittles the concerns expressed by Leegin with regards to its reputation for consistent pricing.[42] Here too, he fails to recognize the simple economic reasoning behind this aspect of the policy: that by maintaining one price for each product, Leegin relieves consumers of the search costs of learning if a particular retailer's offered price is too high. The policy also alleviates any concern that a mark-down is imminent and consumers will be left (no pun intended) 'holding the bag.' One need only think of the stress some shoppers encounter in certain transactions (e.g., buying an automobile) to understand the value to the consumer of such a guarantee. Everyday pricing distinguishes Brighton from pulse pricing used by many department stores.

Finally, Dr. Woods never explains how the effect of Leegin's price policy is to "penalize the consumers of goods" — unless all he means is that if Kay's offered a Brighton purse at $179.99, instead of charging the Brighton SRP of $200.00, consumers must be better off. But this is not sound

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41 Dr. Woods also cites several non-RPM incentives that Leegin offers Heart Store retailers as part of the inducement to maintain adequate inventories, including "better credit terms, financial assistant [sic] acquiring fixtures to sell Brighton products, advertising assistance and additional attention from Leegin's [staff]." See Woods Report, p. 4. However, these non-price arrangements are not in conflict with any antitrust policy of which I am aware. They certainly do not lessen competition.

42 "Leegin also wanted its customers to be free from the concern that they might be 'taken' by paying excessive prices for Brighton products, that the same product might soon be put 'on sale' or offered for a lower price in the same store or other stores, or that they needed to 'haggle' to get the best price." See "Defendant Leegin Creative Leather Products, Inc.'s Initial Disclosures," 9/24/2003, p. 2. Judging from Leegin's growth, many consumers like this type of shopping experience. There is nothing in antitrust analysis that should deny them this option.

economics, even in this contrived example. In Dr. Woods' simplistic analysis, he misses the difference between competition on price *and* service and never grapples with what the world would look like, for Leegin and consumers, if Leegin could not induce retailers to promote the Brighton product line by an SRP policy.

Antitrust law applies in those situations where there has been antitrust injury. This means anticompetitive conduct took place and/or consumer welfare was reduced. Since the logic of a *per se* rule is its application to RPM only where antitrust injury is transparent, it should not be applied in a wooden and mechanical fashion to all vertical price arrangements because most of these are benign. In the case of Leegin, consumers of women's fashion accessories have not been harmed and the competitive vigor of the market has been enhanced by Leegin's entry and growth. Consequently, no antitrust injury was sustained.[43]

VIII. Conclusion

As I understand antitrust law, a manufacturer with a resale price maintenance policy in compliance with the *Colgate*

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[43] I am informed that plaintiffs' damages expert, Mr. James Davis, has estimated damages based on profits allegedly foregone by the plaintiffs once they were no longer Brighton retailers. This strikes me as the wrong calculation. If the court were to conclude that Leegin had entered into an unlawful agreement with retailers, the relevant "but for" world for calculating damages is one where Leegin, under the *Colgate* doctrine, unilaterally refuses to sell to price-cutters. The implication is worth restating since the plaintiffs have gone off track here. Modern antitrust economics puts its chips on harm to consumers. If Leegin's conduct is permissible under *Colgate*, than it follows that an SRP policy instituted "by agreement" does nothing more to harm consumers. As I show in the body of this report, Leegin's SRP policy (whether tagged unilateral or collusive) promotes and does not reduce competition. Also, it is clear that plaintiffs could have mitigated their alleged damages by substituting other merchandise for Brighton products.

doctrine has not violated the Sherman Act because its unilateral conduct means there is no "agreement" between it and downstream retailers. The economic conduct of both Leegin and its retailers is consistent with unilateral behavior (as I demonstrate in my report).

If an "agreement" were found between Leegin and its downstream retailers regarding SRP, a rule of reason analysis is appropriate in this case to make symmetrical the treatment of price and non-price vertical agreements. A *per se* approach is not fitting here because there is no evidence that Leegin's conduct falls within the set of practices that transparently reduce consumer welfare (again, as I demonstrate in my report).

Leegin's business model fits so poorly in the *per se* bin in part because Leegin itself is such an odd candidate for a charge of "vertical pricing control to monopolize the market" and implementing a business practice that "reduces competition." Leegin is a small firm in a market populated with many firms, at both the manufacturing and retailing levels. It has implemented an SRP pricing practice to gain a foothold in this industry. Consumers have been the beneficiaries as have independent retailers who have a brand that is "theirs" and not commonly shared with large, chain retailers.[44] Leegin's SRP policy is not part of a cartel among manufacturers of women's fashion accessories nor part of a cartel among retailers.

With no remotely plausible (or even alleged) horizontal conspiracy in this case, an application of a *per se* rule on SRP would condemn a marketing strategy that increases competition. A far more consumer-friendly rule would be that, in the absence of any horizontal component, vertical arrangements on price would be permissible or, alternatively, be viewed under the rule of reason.

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44 The only exception of which I am aware is Nordstrom's.

Leegin got its start, in part, by offering small independent retailers and chains the prospect that they could make a margin on Brighton products that would compensate them for the time and effort they needed to put into selling the brand. Any retailer who provided the brand-building services to customers (necessary for Leegin to prevail in *inter-brand* competition) could make these investments so long as it was clear that Leegin's SRP policy would be enforced against it and against other retailers. The policy would then mean that retailers would not be undercut by free riders.

As I indicated in Section IV of this report, the focus of my analysis in this litigation is consumer welfare. When the goals of antitrust are discussed, the efficient promotion of consumer welfare generally is recognized as the primary goal.[45] The SRP business model Leegin uses in marketing its Brighton line is pro-competition and pro-consumer. Consequently, if the plaintiffs were to prevail in this case, consumers would be made worse off.

Moreover, the RPM policy of Leegin is designed to help the independent retailer survive and compete. Mr. Jerry Kohl's philosophy, from the early days of starting the Leegin firm as a small manufacturer, was to develop a business model that would enable small retailers to compete against

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[45] Some would argue the only goal. See Robert Bork, *The Antitrust Paradox*. Basic Books, 1978, p. 89. See also Kenneth G. Elzinga, "The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?" *University of Pennsylvania Law Review*, Vol. 125, June 1977, pp. 1191-1213; Philip E. Areeda and Herbert Hovenkamp, "Today it seems clear that the general goal of the antitrust laws is to promote 'competition' as the economist understands that term. Thus we say that the principal objective of antitrust policy is to maximize consumer welfare by encouraging firms to behave competitively, while yet permitting them to take advantage of every available economy that comes from internal or jointly created production efficiencies, or from innovation producing new processes or new or improved products." *Antitrust Law*. Vol. 1, p. 4 (2000).

large chain retailers. For this accomplishment, Mr. Kohl is an honored entrepreneur who has expanded the commercial horizons of dozens and dozens of small retailers. What plaintiffs have managed to do here is bring a lawsuit that not only is harmful to competition, at the same time it is harmful to small business.[46]

What plaintiffs seek to accomplish is the antitrust equivalent of hockey's hat trick except each of the three goals is a perverse one: (1) plaintiffs seek to free ride off the investment of Leegin and other retailers of the Brighton brand; (2) plaintiffs seek to diminish the ability of Leegin to gain retail promotion and brand certification; (3) plaintiffs seek to be awarded damages and injunctive relief without showing any antitrust injury. It would turn antitrust on its head to find that Leegin has, to quote the plaintiffs' Complaint, used "vertical pricing control to monopolize the market" and to "penalize the consumers of goods" when in fact Leegin has used a pro-competitive pricing practice that has aided the economic viability of hundreds of independent retail businesses in the United States.

Respectfully,

/s/

Kenneth G. Elzinga

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[46] One illustration of the internal conflict within the Complaint is that the conduct plaintiffs condemn would be perfectly lawful if Leegin quit dealing with small independent retailers and instead was fully integrated vertically and owned all its retail outlets. Then, Leegin would be free to "set retail prices" at whatever level the company chose without any prospect of antitrust attack. Such a move would, of course, not improve consumer welfare or economic efficiency.